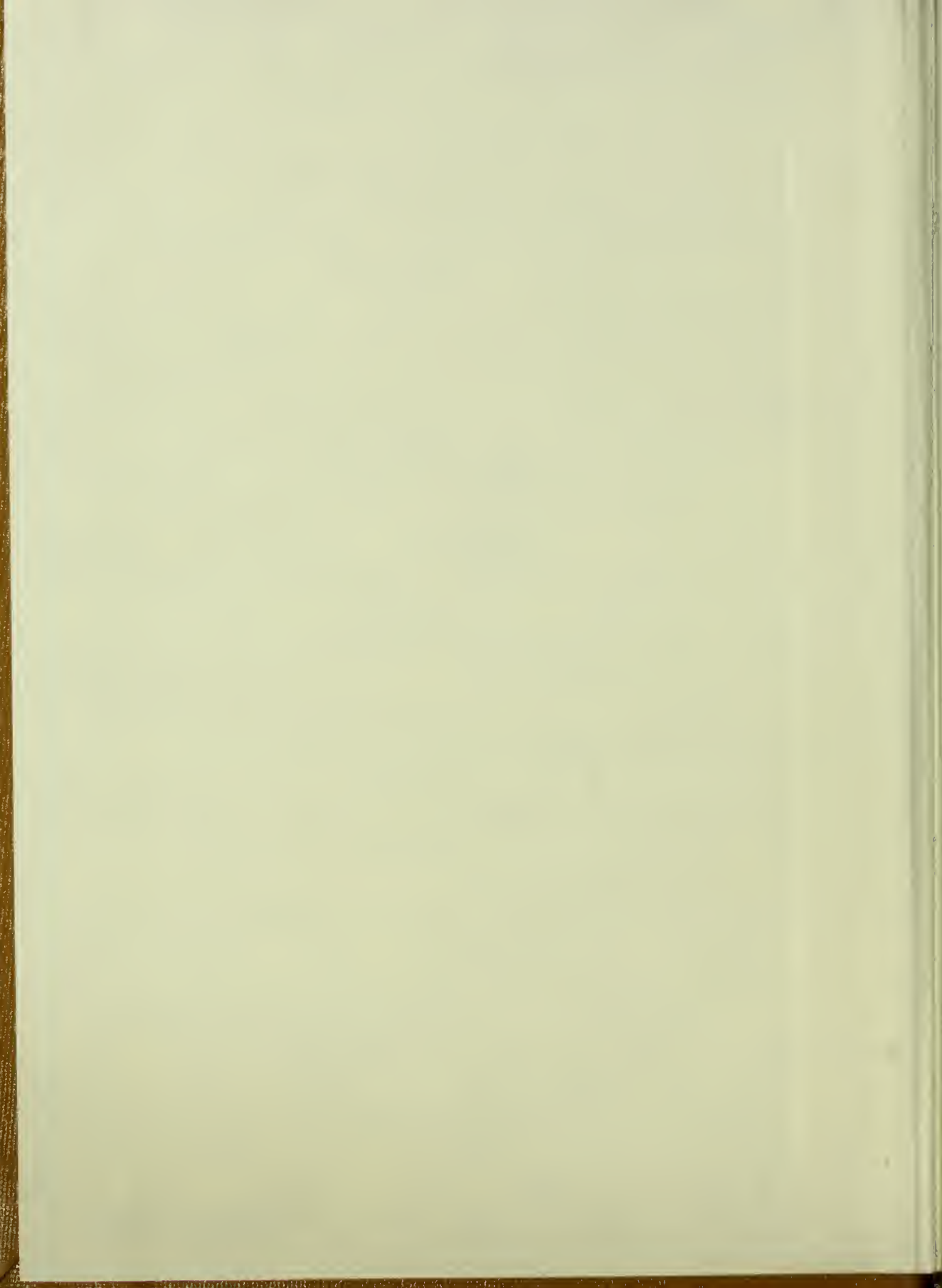
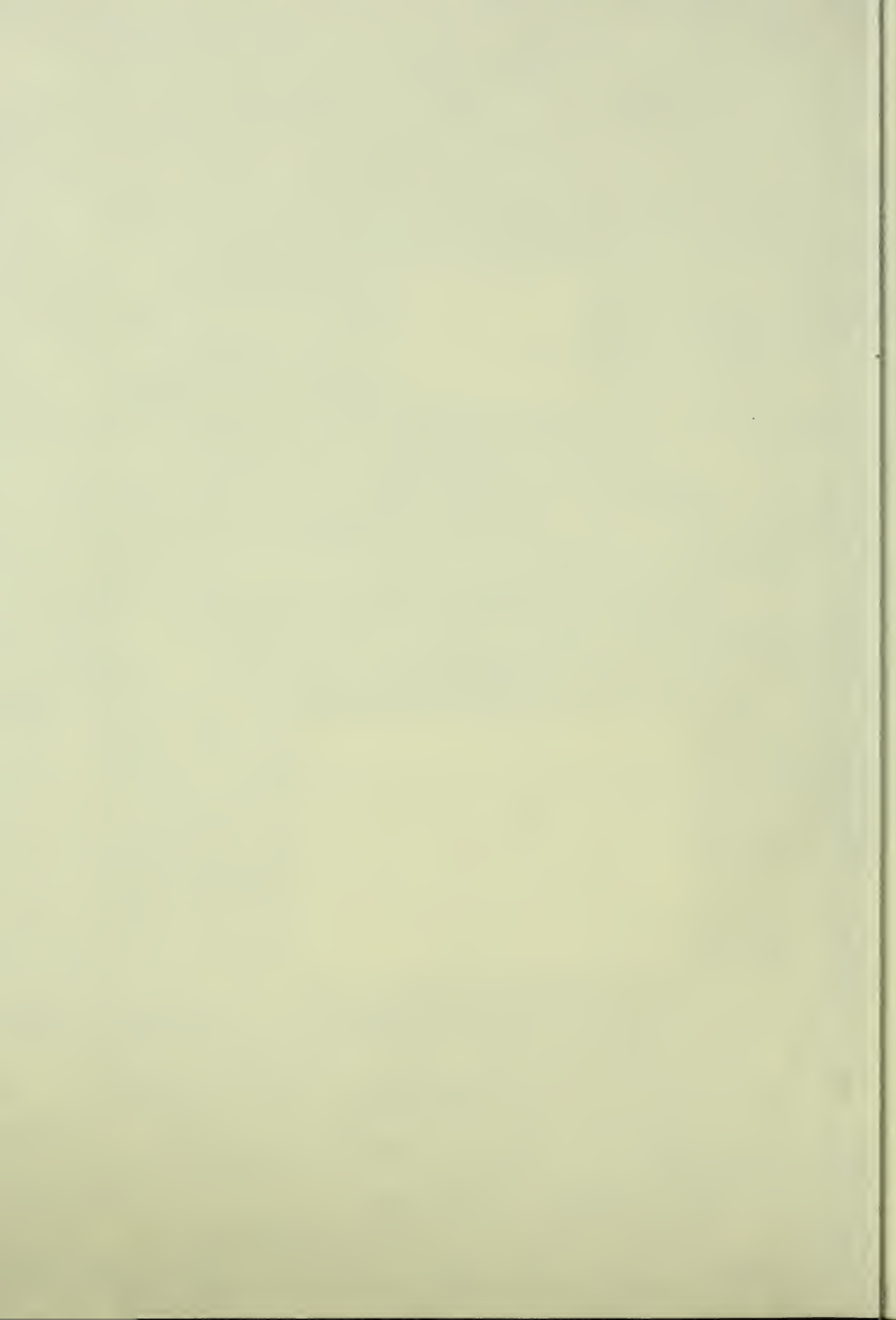




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BusinessWeek

EMBER 5, 2001

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and the EU go
to the jugular?

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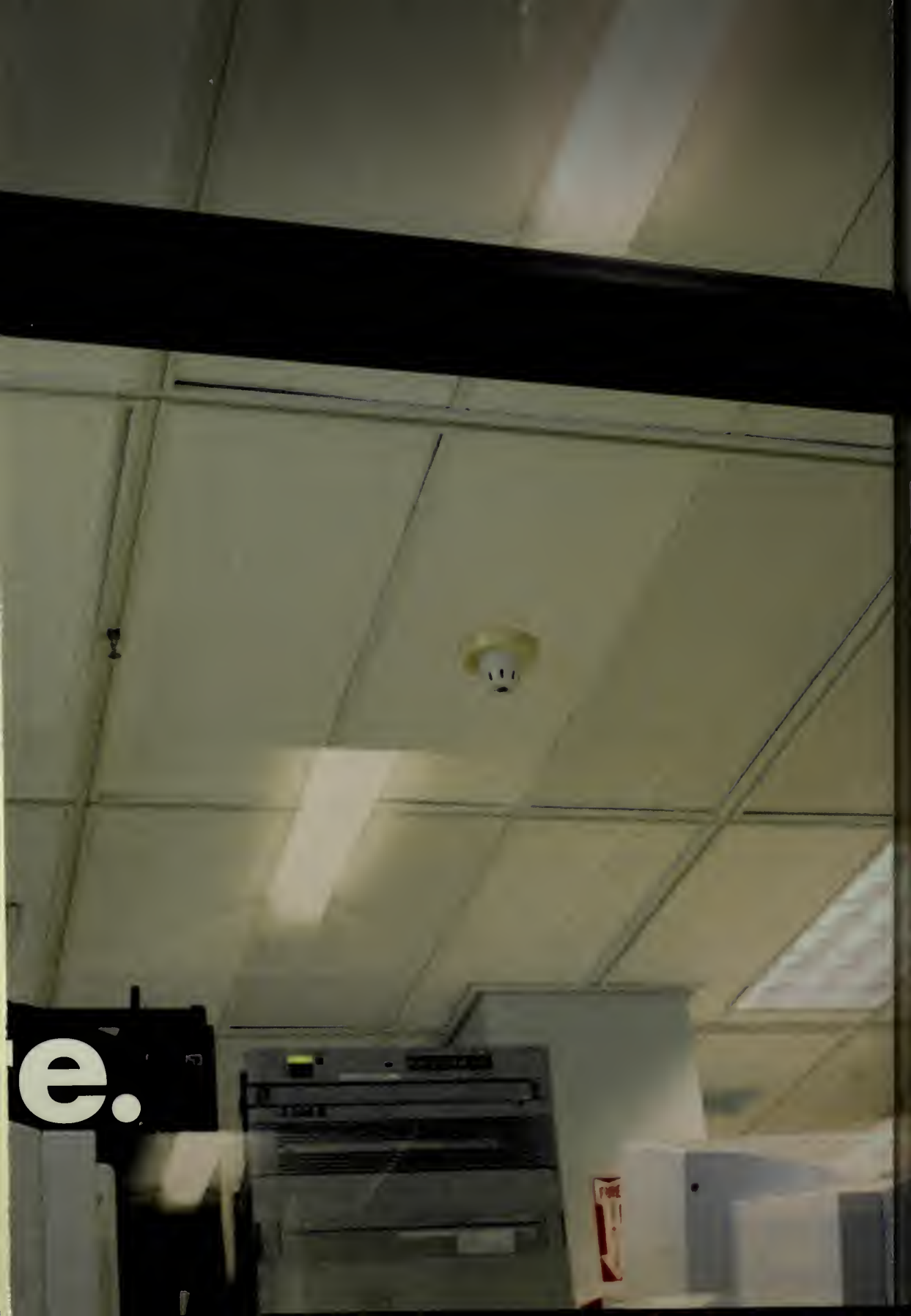
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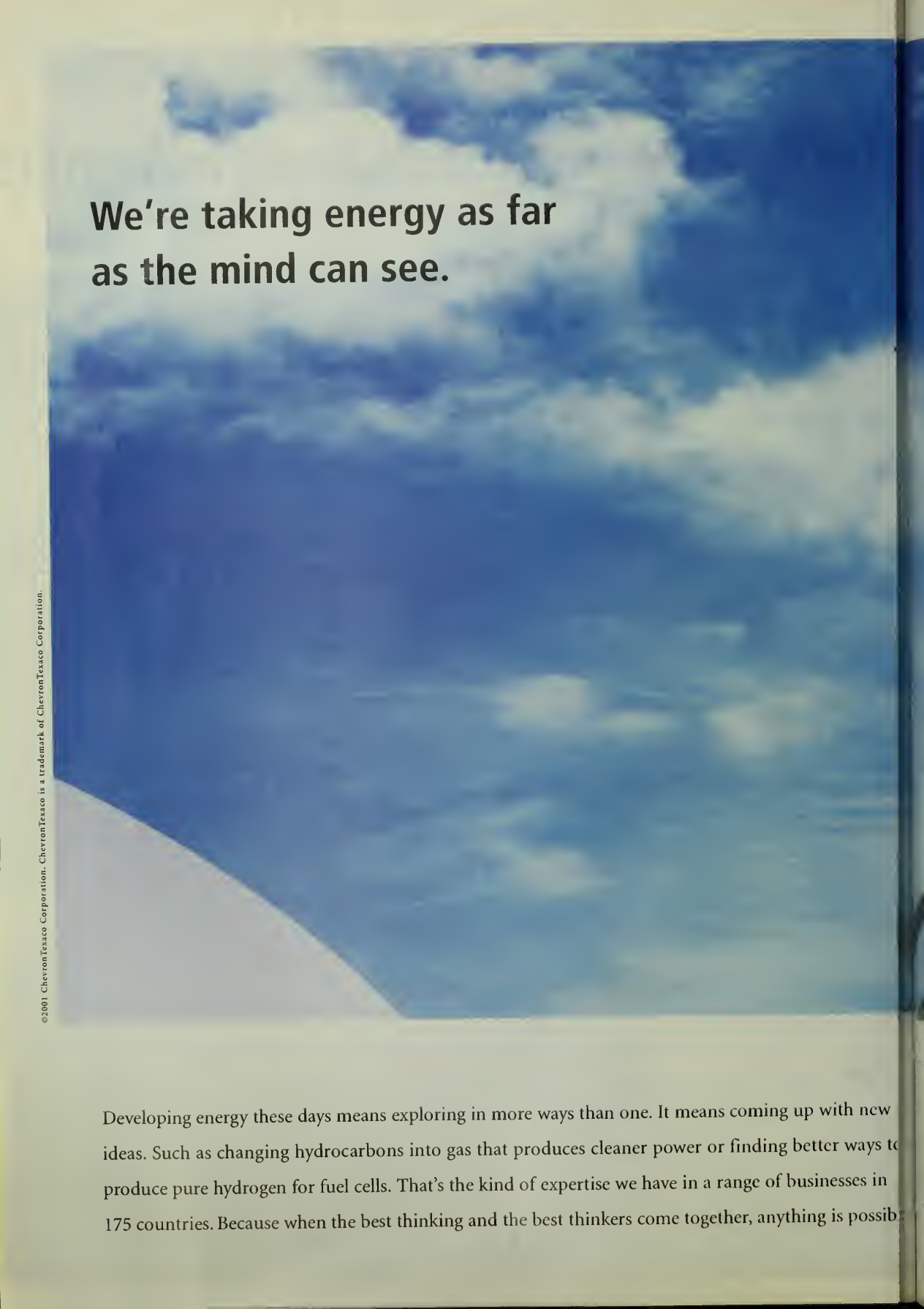
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PRIVACY

To track terrorists, government snoops will have to track you, too
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BusinessWeek

NOVEMBER 5, 2001

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Check on the health of your investments



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Twin Triumphs

At the Asia Pacific Economic Cooperation forum in Shanghai, China basked in the limelight, while President Bush got strong backing for the anti-terror campaign



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Analysis: New gear much like Dr. McCoy's tricorder from *Star Trek* is entering the anti-biowarfare effort



INVESTING In partnership with Standard & Poor's

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Street Wise: If investors look beyond anthrax and other fears that have rattled FedEx, they may see an undervalued company

SMALL BUSINESS A resource for entrepreneurs

www.businessweek.com/smallbiz/

News: It's a union of patriotism and technology as entrepreneurs join the war against terror



TECHNOLOGY State-of-the-art coverage of info tech

www.businessweek.com/technology/

Analysis: Surfers swear by Google, but rivals say it falls short in the corporate market



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Trends: This year, an MBA is no guarantee of a plum job

GLOBAL BUSINESS In-depth coverage of Asia, Europe, and Latin America

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Up Front

EDITED BY SHERIDAN PRASSO

DEAL MILL

BERTELSMANN SAYS PLAY IT AGAIN, NAPSTER

IT'S EITHER A PIPE DREAM OR PROPHECY, BUT BERTELSMANN isn't giving up on Napster, the music file-sharing site currently shut down amid legal wrangling. *BusinessWeek* has learned that the German media giant is kicking in an additional \$25 million to keep Napster alive. That's on top of the \$60 million "loan" Bertelsmann gave Napster a year ago.

Why throw more money at something that has essentially no revenue? Before lawsuits forced it to suspend file sharing, more than 80 million people downloaded Napster software allowing them to swap music tracks for free. No music site ever attracted a fraction of that traffic.

Now, using new software that preserves file-sharing while protecting copyrights, Bertelsmann plans a last-ditch effort to convert people into paying subscribers. Napster will use the \$25 million to relaunch as a paying site. "We think even more than before there's a real business here," says Andreas

Schmidt, CEO of Bertelsmann eCommerce Group.

He's hoping quarreling music companies—who so far have balked at a legal settlement—will recognize that it's in their interests to work with Napster. With two new music industry sites slow to get off the ground, users are flocking to outlaw alternatives. That's the last thing the industry needs after suffering a 5% sales decline in the first half. "Napster is ready to roll," says Schmidt. "Now, it's up to the industry to finally take the opportunity to build a viable business."

Jack Ewing

WIRELESS WORLD

BLACKBERRIES BLOOM ON THE HILL

MEMBERS OF THE HOUSE OF Representatives have a new way to keep up with the latest anthrax cases and other

breaking news: All 435 have been given BlackBerry wireless units. Chairman of the House Administration Committee Robert Ney (R-Ohio), concerned about moribund cell-phone service af-

ter September 11, ordered the devices and one year of e-mail service, at a cost of \$600,000.

But there's a problem. Amid the chaos of anthrax and the devices' rapid disbursement, many members skipped the training sessions and don't know how to use them. Ney

admits some staffers are scrambling to teach their bosses. "There's a couple of them who need to be re-keyed technologically," he says. As for the Senate? No orders yet.

Brian Grow



TALK SHOW "Emergency personnel Tuesday night called a hazardous materials team to a rural Douglas County residence, where a woman feared anthrax has been dropped on her car from an airplane."

The substance turned out to be harmless bird droppings, Sheriff Rick Trapp said."

—Lawrence (Kan.) *Journal-World*

UP, UP, AND AWAY

THE LITTLE BIRDS GROW STRONGER

EVEN AS UNITED WARNS IT "will perish" next year without major cost-cutting, scrappy low-fare upstarts—including JetBlue, AirTran, and Frontier—are showing surprising resilience.

And they're seizing opportunities opened up by the recent retrenchment of the major carriers. AirTran, for instance, will start service to Baltimore in December, earlier than planned, thanks to the demise of US Airways' low-fare MetroJet. JetBlue, which has raised nearly \$100 million from investors since September 11, is adding seven new flights to Florida, where rivals have trimmed capacity



SMALL FRY: Opportunity

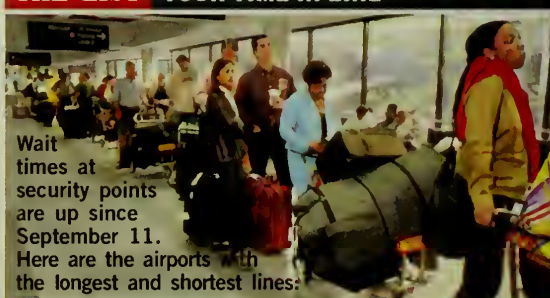
by a third. "There's a feeling that we could come out of this better positioned than going in," says Frontier President Jeff Potter.

Lower costs and greater flexibility are key, especially as fares and revenues drop. And the small fry depend less on big, minute, high-business travelers who were ready to pull back. Plus, the biggies cut market share and service, so they'll have a hard time climbing a better

product than low-cost rivals pushing new safety features.

Others are smelling opportunity, too. "I've had so many people call me about starting an airline lately," says R. L. Jenkins, director of George Washington University's Aviation Institute. Crazy? Maybe. But not ever called the airline business sane. *Wendy Ze*

THE LIST YOUR TIME IN LINE



Wait times at security points are up since September 11. Here are the airports with the longest and shortest lines:

LONGEST WAITS	PERCENT REPORTING WAITS OF MORE THAN AN HOUR	SHORTEST WAITS	PERCENT REPORTING WAITS OF LESS THAN 30 MIN
BALTIMORE/WASHINGTON	58%	HOUSTON INTERCONTINENTAL	5%
SAN FRANCISCO	56%	INDIANAPOLIS	
DENVER	53%	DETROIT	
LOS ANGELES	47%	NEW ORLEANS	
PHILADELPHIA	46%	NEWARK	
BOSTON	46%	PORTLAND (OREGON)	

E-mail survey of 2,878 adults traveling Sept. 12 to Oct. 2

Data: Travelocity

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Up Front



POSTAL MENACE: Handle with care

are hot, too: MasterCard ordered 14 million from Brenner Paper for an upcoming marketing pitch—by chance just before September 11. Steve Johns, president of PrintMail-

ers, a Houston outfit that handles direct mail for 250 companies, is advising clients to "put more identification on their outside envelopes, [and] move from envelopes to postcards." Some publishers are instructing printers to leave off the cornstarch usually applied to shrink-wrapped magazines to prevent them from sticking together. Gone, too, are those handwritten fonts on mass solicitations.

Some mail promotions are backfiring. To trumpet a merger with another firm specializing in environmental law, attorneys at Stael Rives in Portland, Ore., mailed out 50,000 cards—in bumpy envelopes containing seeds, too. Scared recipients called 911. Publishers Clearinghouse created alarm by mailing 1½-lb. packages of powdered detergent as a bonus to customers. If all this results in less junk mail, that would be at least a small compensation.

Dean Foust, with Brian Grou

BIOTERROR

EVOLUTION OF THE ENVELOPE

IS THIS THE DEATH OF SNAIL mail? Are e-mail, online payments, postcards, and see-through envelopes the wave of the future?

With anthrax scares leaving us afraid to open our mailboxes, that seems to be the case. "Certain chunks of the mail stream will either be delivered electronically or will disappear altogether," says Michael Critelli, CEO of mail and document manager Pitney Bowes. Consumers are suddenly showing interest in electronic billing: Princeton eCom Corp. says sign-ups for its electronic mortgage payments have increased more than 20% in recent weeks, although it attributes that to other factors besides anthrax.

Hallmark will soon begin printing postcards for Christmas. Transparent envelopes

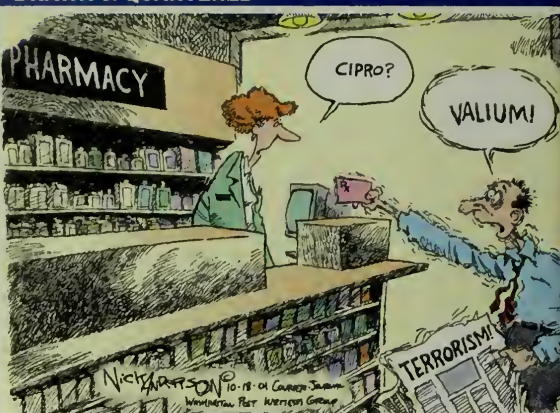
Bureau in Tokyo. "Japan people are worried about the safety," says a spokeswoman.

To drum up business, Governor Benjamin Cayetano a five-day emergency mission to Osaka and Tokyo started on Oct. 8 and timed to coincide with a big ad campaign.

Hawaii is spending up to \$7 million a day on television spots. Visits are down 40% from last year, but the state is trying to lure back the 25% of tourists who come from Japan.

JTB, Japan's biggest travel agency, says many who were planning trips to Hawaii are booking domestic vacations instead. "Travel within Japan is up 20% to 30% over the last year," a JTB spokeswoman says. Among the popular destinations: Disneyland. Chester Da-

DRAWN & QUARTERED



VACATION NATION

HAWAII: WOING BACK THE JAPANESE



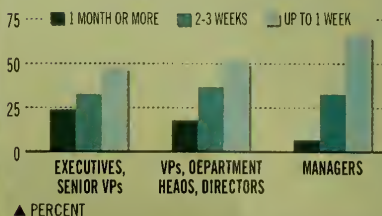
HAWAII, BADLY HURT BY THE falloff in tourism since September 11, is trying to do something about it—in particular, lure back the 25% of tourists who come from Japan. Trips by these big spenders, the most frequent foreign visitors to Hawaii, are down 40% since last year. The state stands to lose up to \$1 billion in revenue if Japanese arrivals don't pick up, according to the Hawaii Visitors & Convention

THE BIG PICTURE

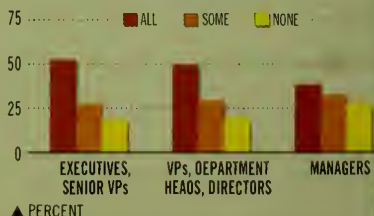
LAYOFF PACKAGES: HOW THEY STACK UP

Higher-level employees get more of a financial cushion when they're laid off than mid-level ones. Here's how the differences break down by rank:

SEVERANCE PAY PER YEAR OF SERVICE:



OUTPLACEMENT HELP GIVEN TO:



SURVEY OF 925 COMPANIES, MAY 24 - JULY 6

Data: Lee Hecht Harrison and Fitch

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

Software quality ↑ 80%

Developer productivity ↑ 300%

ROI ↑ 1400%

Testing time ↓ 95%

Development cycle ↓ 66%

Lump in throat ↓ 100%



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LEARNING FROM INTEL'S MISTAKES

While "Intel" (Cover Story, Oct. 15) brought up some good examples of how Intel Corp. has failed to achieve its objectives, I don't understand your comparison between Intel and Advanced Micro Devices Inc. Intel has driven many of the standards in desktop PCs, notebooks, and servers, and the company is doing the same in networking, PDAs, wireless, the Internet, telephony, broadband, digital TV and photography, and the integration of many of these technologies. Intel has taken on tremendous risks but has also reaped the rewards of many of these risks.

AMD, by contrast, develops me-too, copycat products, then sells them at any price that will move them. Intel creates value in a variety of markets. AMD sucks value from the markets it enters.

Dan Roller
 Las Vegas

Surely Intel could have learned from the example of many companies that have strayed from their core competencies and failed miserably. Intel is not nimble, and competing in new markets is an enormous challenge to a company accustomed to being the only choice in a market. Intel must concentrate on what it does best: making the best microprocessors. It should adhere to the plan to automate to reduce manufacturing costs by 50%, regain its leadership position, and maintain a commitment to just one of the new markets, wireless

communications, where demand will continue to explode worldwide.

Erik L. Johan
 West Hartford, Conn.

COUNT CANADIANS AS TRUE FRIENDS OF THE U.S.

"The roots of resentment" (Special Report, Oct. 1) hints that Canada among the nations that "hate" America. The protests that took place in Quebec in May, 2001, were directed at globalization, not at the U.S. Canada and people of all provinces remain friends to the U.S., particularly in difficult times.

Frederick Constant
 Montreal

THOSE 'JAPANESE' WERE AMERICAN CITIZENS

Your statement that "Japanese" is misleading ("Security vs. liberties," Special Report, Oct. 1). People interned were Americans. Japanese-Americans of Japanese descent were sent to internment camps solely on the basis of their ancestry.

T. Toki
 Los Angeles

PROTECTING NUCLEAR PLANTS FROM ATTACK

In the aftermath of the terrorist attacks in New York and Washington, some irresponsible groups have questioned the security at the nuclear power plants ("The nuclear power plants are just getting more real," Special Report, Oct. 1). Nuclear power plants among the most secure industrial facilities in the U.S. before [the attacks] they are even safer today. At each

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RECTIONS & CLARIFICATIONS

chfire Inc., a collaborative negotiation ware company, is still privately owned based in Boston ("Wall Street: The big I," Special Report, Oct. 22). Chairman Coes is not "bitter" about advice from investment bankers to take Beachfire pub- last year: He considered it premature.

contents page entry for the Barker Port- (Oct. 29) should have listed Rappaport Mauboussin as authors of *Expecta- is Investing*—not Bernstein and Lei- nitz, who merely endorsed the book.

Selling Furniture and Tolerance" (People, . 22) about Ethan Allen Interiors Inc. I M. Farooq Kathwari, the name of Kath- i's late son should have been Irfan. *BusinessWeek* apologizes for the error.

st steel and concrete structures sur- d the reactor, one of several barriers protect the reactor fuel. In addi- expertly trained security forces tain high levels of security against rism around the clock. The chance a terrorist attack on a nuclear facil- ould result in a large release of ra- tive material is extremely low. ven before September 11, the in- y was taking steps to strengthen ty. This month, the industry—with U.S. Nuclear Regulatory Commis- oversight—began a pilot program hance the effectiveness and com- ensive nature of our security pro- evaluations. e industry's security program has onstrated its effectiveness in re- ng mock ground-based terrorist at- s, and the industry works with local, and federal authorities to ensure public health and safety is protected. Ralph Beedle Chief Nuclear Officer Nuclear Energy Institute Washington

I. S. STEEL, MERIT RAISES ARE IN DOUBT

s a 34-year veteran of U.S. Steel in Alabama, it was encouraging e CEO Thomas Usher come out so ("Secrets of the truly shameless," *BusinessWeek* Investor, Oct. 1). We heard that our "merit" raises this would be on an "emergency" basis due to poor business conditions. I I was hoping to get the whole his year.)

John Niolon Hueytown, Ala.

SOME EGGS TAKE LONGER TO HATCH THAN OTHERS

I find it offensive that in one of the worst stock-market years in history, Toddi Gutner lambastes the Chicks Laying Nest Eggs investment club portfolio over the short term ("Chicks' picks come home to roost," *BusinessWeek* Investor, Oct. 8). We consider AOL Time Warner Inc. part of the whole big picture—and [buy] it as a tie-breaker when we are undecided between two compa- nies. We chose not to sell Gap Inc. be- cause we believe in their fundamentals.

As for our tech-heavy portfolio, the companies we own have a lot of cash, great margins, and will be around for a long time. They are solid companies in a down market. We would buy them again tomorrow.

Karin Housley St. Mary's Point, Minn.

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THE CHASTENING

Inside the Crisis that Rocked the Global Financial System and Humbled the IMF

By Paul Blustein

PublicAffairs • 431pp • \$30

CLUELESS AT THE IMF

Just three years ago, long before the panic over bio-terrorism, the world was gripped with fear of a different contagion: an epidemic of financial crises. These first infected such economies as Mexico, Thailand, Indonesia, and Russia—and then struck close to the U.S. financial nervous system with the September, 1998, near-collapse of hedge fund Long-Term Capital Management.

These days, you don't hear as much about financial contagion. True, the International Monetary Fund has had to stamp out financial fires in Argentina and Turkey. But such crises haven't spooked the global currency markets nearly as much as they did in the 1990s. Nor do we read as much about frantic calls for reforming the "international fi-

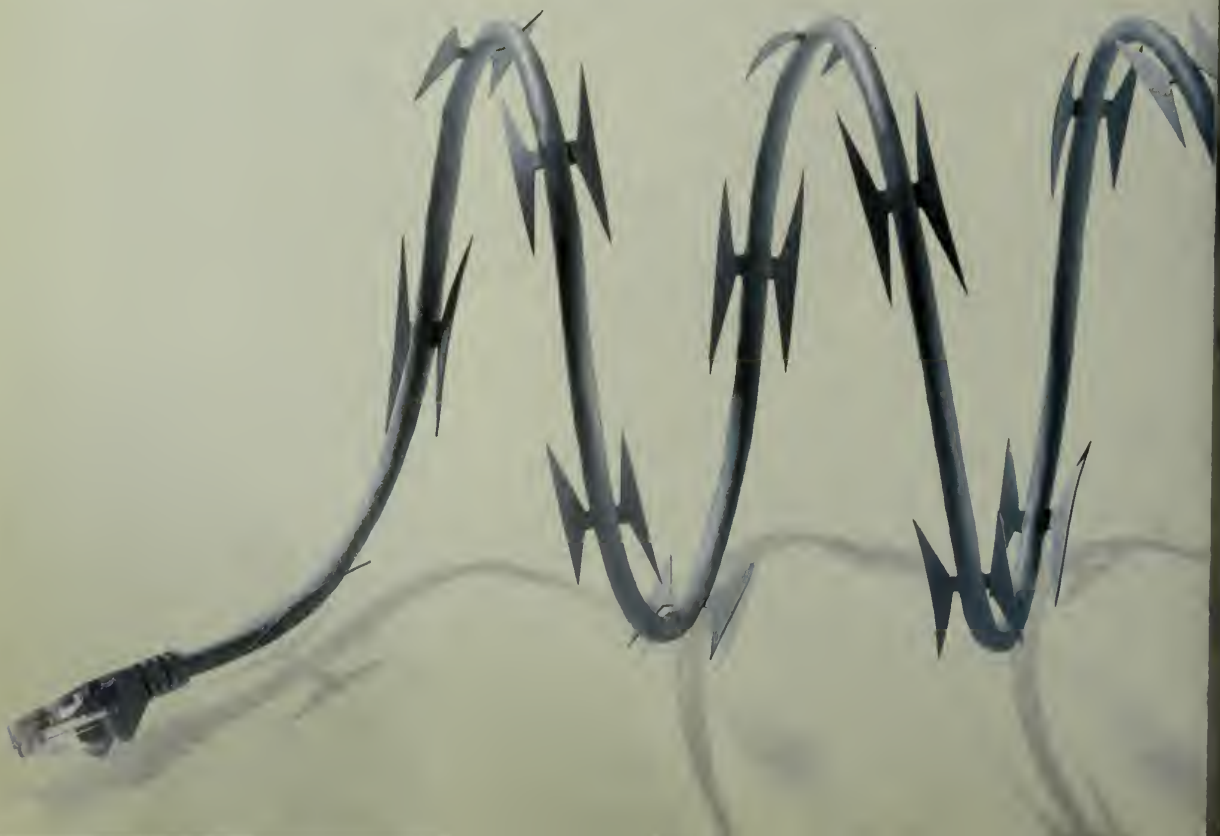
nancial architecture," an issue that once obsessed Wall Street and leading U.S. think tanks.

This raises some interesting questions. Have investors and bankers perhaps learned their lesson about the hazards of pumping billions of dollars of hot money into risk-prone emerging markets? The IMF was much maligned for its failure to foresee and manage the meltdowns in Southeast Asia and Russia. Could it be that the IMF didn't do such a bad job after all, given the perilous, enormously complex challenges it faced?

After reading *The Chastening*, the exhaustively reported narrative of the bailouts of Brazil, Indonesia, Mexico, South Korea, Russia, and Thailand by *Washington Post* journalist Paul Blu-

stein, one is still left wondering. One reason is that the book is thin on its analysis of what the IMF, the capital markets, and developing nations learned from these debacles—or how to combat the next ones. But then, the crises of the 1990s came so unexpectedly that much of that period was simply a blur. And Blustein notes, Brazil pulled out of crisis and averted recession in 1999 after the IMF insisted it hike interest rates and slash spending—policies that failed disastrously in Thailand and Indonesia.

The Chastening's main accomplishment is to clear up much of the mystery about what went on behind the scenes during the big bailouts of the 1990s. Benefiting from near-complete access to most officials who were directly involved, Blustein chronicles in meticulous detail how what he calls the "Financial Command"—the IMF, the U.S. Treasury Dept., the Federal Reserve, and other finance leaders of the Group of Seven countries—crafted the rescue plan for Mexico, East Asia, Russia, and Brazil along with the many mistakes and misadventures along the way. He shows how, despite its confident, all-knowing facade, the IMF and its army of classic-trained economists were clueless at



workings of modern capital markets and the shady complexities of Asian political and corporate finance.

Blustein also details the stormy arguments inside the High Command. We see, for example, of former World

Chief Economist Joseph Stiglitz squaring off with then-Deputy Managing Director Jeffrey Fischer over interest- and fiscal-austerity policies. He relates the feud between the State Dept. and Treasury over how much restraint to force upon President Clinton, who eventually lost. We also read of Treasury's blatant role in pushing business interests of Wall Street by using bailouts to pressure nations to open their capital markets to foreigners.

The overall portrait of the world that emerges pretty much squares with what many observers have long suspected: From being an omnipotent god, the IMF is no better informed economically astute than any number of players. Too often, its policies are the result of guesswork or backroom maneuvering rather than an intimate understanding of developing nations. Still, Blustein chastises the IMF for its arro-

gance and blunders, Blustein also gives it some credit. After the global financial system seemed on the brink of disaster in late 1998, when Russia defaulted on foreign bonds, the contagion quickly abated once the G-7 lowered rates, the Fed engineered the rescue of Long-Term Capital, and Brazil's crisis eased.

In fact, given the nature of modern international finance—in which myriad investors whisk billions in and out of countries for obscure reasons—the IMF may simply be out of its depth. "Glo-



Blustein says the bailouts were made in ignorance of how capital markets work

bal capital markets have gotten so huge, so unruly, and so panic-prone that the High Command can be easily overwhelmed," Blustein observes.

What's the solution? In a cursory final chapter, Blustein lists and then dismisses as impractical many popular propos-

als for reforming international finance. Except for one: He notes that in two bailouts that eventually worked well—Korea and Brazil—the biggest debtors were banks, and the key borrowers were governments. The banks agreed to roll over maturing debts until a game plan for resolving the crises was worked out. Blustein endorses a similar system for private debt. The IMF would enforce a temporary halt of hard-currency repayment of corporate bonds and short-term loans, the main problem in Indonesia, Russia, and Thailand. But this, too, would be hugely problematic.

Perhaps a better remedy is for emerging markets to just avoid hot money if their financial systems can't handle it. In effect, this situation already exists: Since the Russian default, short-term private-capital flows to emerging markets have slowed sharply. Therefore, there's less money for speculators to pull out because of panic somewhere else. Of course, with growth in emerging markets still expected to outpace the West, the fast-money crowd won't stay away forever. With luck, both investors and future IMF staff will learn from the mistakes of the 1990s.

BY PETE ENGARDIO

Senior News Editor Engardio is co-author of Meltdown: Asia's Boom, Bust, and Beyond.

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SOUND WORDS

THOSE WITH MORE DRIVE TIME THAN reading opportunity no longer have to go without a dose of Jack Welch. *Jack: Straight From the Gut*, the No. 2 hardback on this month's list, is now available in audio. There's a 14-hour full-length version, read by *New York Daily News* columnist Mike Barnicle. But you'll likely want the 6-hour abridged rendition, since it features the raspy, Massachusetts-accented voice of the author himself (TimeWarner, \$25.98 for cassettes, \$29.98 for CDs).

Most chapters have been streamlined, and that's largely the good. Winning, very personal bits remain—along with phistic and unpersuasive section on ranking GE personnel chapters are entirely excised. The most serious loss is chap 15, "Too Full of Myself," on GE's 1986 acquisition of K. Peabody. Here, Welch rants against Wall Street's "entitled culture" and tells of his "worst nightmare"—the discovery of a "\$350 million hole" in trader Joe Jett's account.

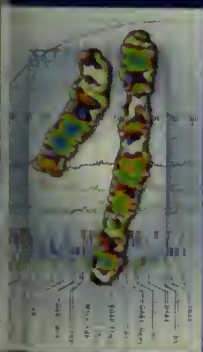
BY HARDY C.

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

XP'S DO-IT-YOURSELF SECURITY



The good news is that XP offers solid protection. The bad news is that you have to search out and set up features that should be front and center

In Windows XP, Microsoft is finally offering an operating system designed for consumer use that offers solid security. The entire computer can be off-limits to anyone without a user name and password, and all individual users control who has access to their files. You can safely share some files on a network while keeping others private. There is even a simple firewall to deter intruders lurking on the Internet.

There's only one problem. When you buy a new computer with XP or upgrade an existing one from Windows 98 or Me, most of the good security features are turned off. Unlike those versions, XP can be made secure. But Microsoft has left it up to you to make that happen.

CREATE PASSWORDS. For example, Windows XP automatically comes with an account called "administrator," which has no password. If you don't do something about it, your computer will always have a huge security hole because anyone can gain access just by typing "administrator" and hitting return. During setup, you are asked for the names of the users of the computer. Windows creates an account with each name, but again, they start off with no passwords. Every account should be protected by a password. Requiring a password to log on to your own PC is a bit of a nuisance, but as we have learned in so many other areas, giving up a little convenience to gain security can be worth the trouble.

For the best security, I recommend that everyone normally use a "limited account" and log on to an "administrator account" only when needed—for example, when installing software. But make sure you remember the administrator-account password since there's no way to recover it if it gets lost.

To get the full benefit of user accounts, you have to take another seemingly unrelated step. Windows XP offers two different systems for storing files on your hard drive. The distinctions aren't worth going into, but the method, called

FAT32, which is also used by Windows 98 and Me, is far less secure than the alternative, called NTFS. Running FAT32 disables many XP security features. You can set up separate accounts for your kids, but they may still be able to get to your files. When you share files over a network, you can't be sure that access is limited to material you want to make public.

If you install XP yourself, you are offered a choice of file formats. But most computer manufacturers ship XP systems with FAT32. Microsoft includes a utility to convert drives without disturbing their contents, but it's hard to find. The simplest way to discover it is to search for "convert" after clicking Help and Support in the Start menu. (Windows XP comes with excellent online help, but it's no substitute for a printed manual. When you pay \$100 for a piece of software, you shouldn't have to shell out an additional \$30 to \$50 for a book on how to use it.)

If your computer is connected to the Internet with anything fancier than a standard dial-up modem, you are vulnerable to hackers and need some sort of protection. Microsoft has included a protective firewall as part of Windows XP. There are more sophisticated products around from companies such as Symantec, Network

FOR MORE ON WINDOWS XP...

This is the last in a series of columns on Windows XP. Here is a list of prior pieces, which are available at www.businessweek.com/technology/, along with online-only articles.

SEPT. 10 Windows XP: Look Past the Bad Press

OCT. 8 Windows XP: Time To Buy a New PC

OCT. 22 Windows XP: It's a Keeper

OCT. 29 How To Sidestep XP's Pushy Pitches

associates, and Microsoft's Labs. Microsoft's position is adequate for

people, and it's already installed on every machine, but it won't help unless you turn it on. Fortunately, that's simple to do, though more obscure than it ought to be. Once again, use Windows Help, search for "firewall" and follow the step-by-step instructions for enabling the Internet Connection Firewall.

Microsoft products have long been criticized for sacrificing security in the interest of convenience, and nowhere has this been more true than in consumer operating systems. Windows Home goes halfway toward rectifying the problem. All the tools are there, but in the interim, making things easy, Microsoft's defaults have too many of them to go unused.

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BY ROBERT J. BARRO

WHY THE WAR AGAINST TERROR WILL BOOST THE ECONOMY



STIMULUS:
Increased government spending at levels of around 2% of GDP should help the U.S. avoid recession in 2002

There is still a lot of uncertainty about how the U.S. military effort in Afghanistan will affect the U.S. economy. To analyze the likely economic impact of the war, I think of the current action as analogous to U.S. wars of the past. My main conclusion is that the current war will be expansionary and will, therefore, help the U.S. economy recover from its current slowdown.

If we consider World War II, Korea, and Vietnam, we have examples of large, medium, and small wars. In World War II, peak military spending in 1944 was 60% to 70% of prewar gross domestic product. During the Korean War, spending peaked at around 11% of GDP in 1952, and during the Vietnam War, it peaked at about 2% of GDP in 1968. The evidence is that economic activity expanded during each war but by less than the amount of wartime spending. My estimate is that each \$1 worth of military outlays led to a 60¢-to-70¢ increase in GDP. To put it another way, while military spending raised output, there was no free lunch. The spending had to be paid for by decreases in other forms of spending, especially business investment (and by more work effort).

The economic effect of the Gulf War is harder to isolate because military spending rose by only about 0.3% of GDP. The economy was in a recession in 1990, before the war started in January, 1991. Economic growth resumed by the second quarter of 1991 but remained low until 1992. The analysis from the other three wars suggests that little of the recovery stemmed from the Gulf War.

SPENDING HIKES. For the current war effort, if we sum up the likely near-term added expenditures for the military, domestic security, and reconstruction of New York City, we get at least 1% of GDP. This calculation is likely to underestimate added wartime spending because we will probably also see a long-term reversal of the "peace dividend" that resulted from the end of the cold war. During the Clinton Administration, from the end of 1991 to the end of 2000, defense outlays fell from 6.2% of GDP to 3.8% (and the number of military personnel declined by around 1 million).

Given the insecurity of the post-September 11 world, I would expect a long-lasting increase in defense spending. If the U.S. responds as it did during the Reagan Administration's defense buildup of the early 1980s, defense spending would rise another 1% to 1½% of GDP over a one- to two-year period. Thus, the overall spend-

ing stimulus from the war on terror will likely be similar to the extra 2% of GDP that was expected at the peak of the Vietnam War. Using that kind of economic response mentioned before, where GDP rose by 60¢ to 70¢ for each dollar of military outlay, this stimulus is likely to help the economy avoid a recession in 2002.

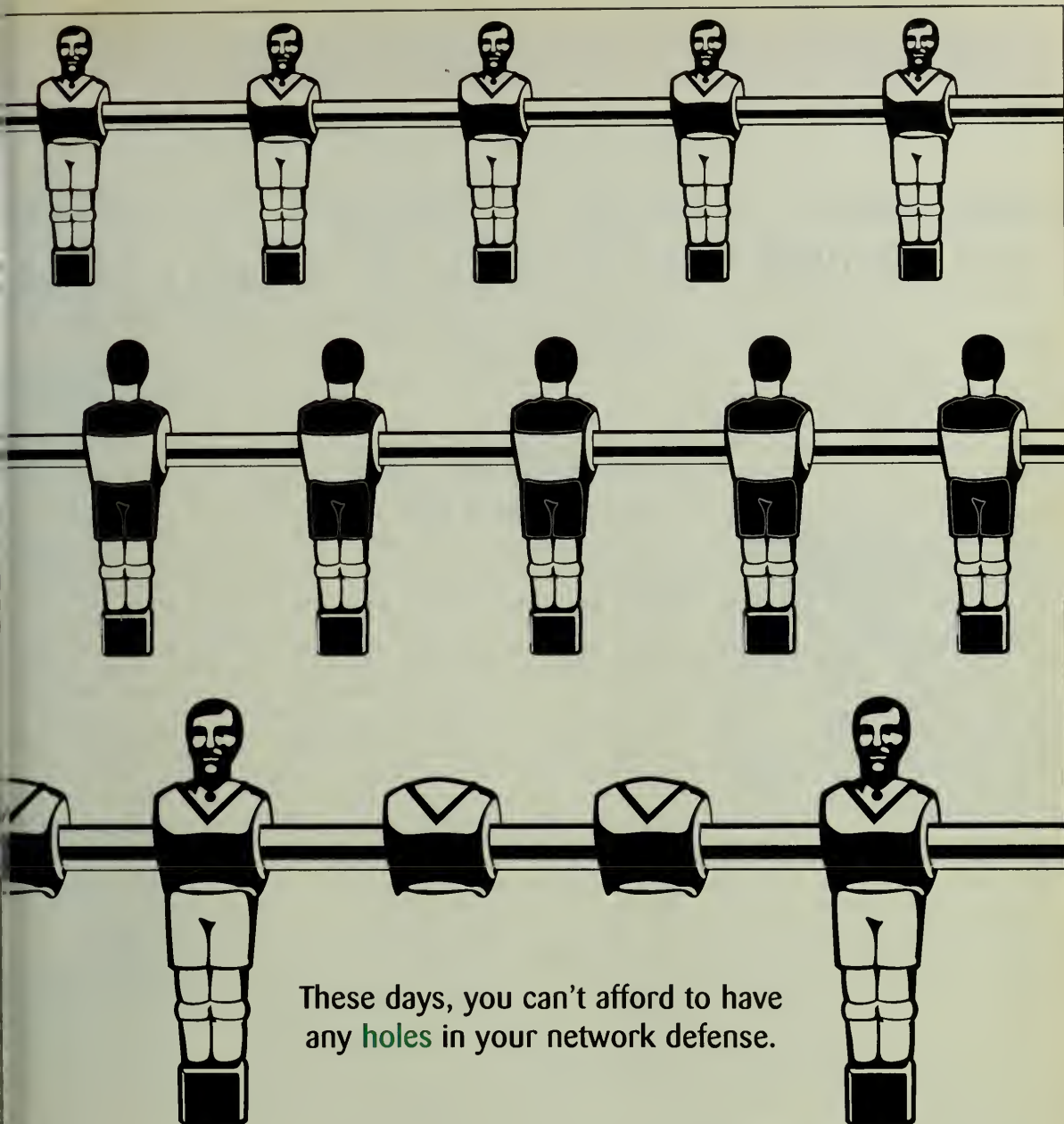
Not all aspects of wars are favorable to economic activity, of course. Consumers' perceived increased risk of flying, for example, lowers demand for air travel, and the perceived high risk of terrorism likely reduces business investment. However, negative effects were also present in previous wars, including worries about the Japanese invasion of the U.S. mainland during World War II and about Soviet missiles during the cold war. Nevertheless, the net effect of previous wars on U.S. GDP turned out to be positive.

NO BAILOUTS NEEDED. One concern about the current situation is all the nonsensical proposals in Washington for fiscal stimulus beyond the expenditures for national security and the reconstruction of New York. It seems reasonable to regard security in airports and on airplanes as public goods that should be supervised and perhaps partly financed by the federal government. But there is no economic rationale for general bailouts or subsidies of airlines, insurance companies, the steel industry, agriculture, and so on. After all, it is not only during tranquil times that we ought to rely on free markets rather than the government to allocate resources. The risky new world means that air travel is less safe or that threats of domestic terrorism are greater, then the unfettered market will generate less air travel and higher insurance rates. This may also mean fewer functioning airlines and some reorganizations of ownership. These seem to be the correct outcomes, at least if our government succeeds in reducing the various threats.

On the tax side, one thing we surely do need is more rebates, which were never a true economic stimulus. Accelerating the planned rate cuts would be fine, but limiting them to lower-income people makes no sense in terms of encouraging economic activity. Any fundamental changes in tax policy should be aimed squarely at improving incentives for households and businesses to produce and invest.

Overall, I expect the U.S. economy to expand during 2002. But it is possible that the government will come up with a fiscal package that is bad enough to prolong the slowdown.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).



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OLDER NOW —AND STEADIER

As boomers age, joblessness drops

With the U.S. apparently in a recession, economists are still unraveling an enduring mystery from the unprecedented expansion of the 1990s. How could the unemployment rate fall from 7.5% in 1992 to 4% in 2000 without triggering the surge in inflation that many of the nation's economists expected?

HOW AN AGING WORKFORCE LOWERS UNEMPLOYMENT



Data: Bureau of Labor Statistics

As with so many other trends that have marked the U.S. economy since World War II, the answer may lie in the aging of baby boomers, suggests one recent study. In the October issue of *The Regional Economist* from the Federal Reserve Bank of St. Louis, Abigail J. Chiodo and Michael T. Owyang observe that the labor force grew much more elderly in the 1990s. The share of workers 35 and older rose from less than 54% of the labor force in 1990 to almost 62% today, a level not seen since the mid-'60s (chart).

The study found that the aging labor force accounted for half of the eight-year drop in unemployment, since workers over 35 typically have a rate of unemployment only half that of younger workers. The study cites earlier research by Robert J. Shimer of Princeton University to explain the impact on unemployment and inflation. Shimer argued that older workers were more skilled and more likely to be matched with jobs where they were productive, thus holding down inflation. By contrast, younger workers are more prone to moving in and out of jobs in search of a career that suits them, which shows up as higher unemployment.

The St. Louis study also found that improving technology helped keep low

unemployment from rekindling inflation by increasing worker productivity. But who knows whether technology can continue to play that role? The age composition of the labor force for the next few years is about as predictable as economic variables get, and Labor Dept. projections show the 35-and-over group rising to almost 63% of the total in 2008. That suggests that the next expansion will benefit from the same anti-inflation influences as the previous one.

By G. David Wallace

HUH? TINKER WITH SOCIAL SECURITY?

Both rich and poor might do better

Opponents of supplementing Social Security with private retirement accounts argue that such an arrangement would hurt the poor. They claim that poor retirees, with no investment experience, would be more apt to lose money in the stock market. But a new study by Jagadeesh J. Gokhale, senior economic adviser at the Federal Reserve Bank of Cleveland, says that individual accounts could actually help low-income families by making it easier for them to accumulate financial assets.

Gokhale says that low-income people find it hard to save because so much of their pay goes toward Social Security taxes—and they don't see the need to save for retirement because Social Security benefits will cover most of their retirement needs. As a result, he says, they don't accumulate wealth.

The Fed researcher created two computer simulations of the U.S. economy: one with Social Security and one without it. He found that, under the current system, a child who grows up in a family with few financial assets—defined as having less than \$99,000 in cash, life insurance, and stocks—has a 40% likelihood of retiring with little in the way of assets. But if Social Security were replaced with individual accounts, calculates Gokhale, the person's probability of retiring with less than \$99,000 in assets would fall to 16%. The likelihood of retiring with \$245,000 to \$455,000 in assets would nearly triple, to 28%, and the chance of amassing more than \$455,000 would more than double, to 11%. (All sums are in 1995 dollars to remove the effect of inflation.)

Gokhale thinks the rich, too, would do pretty well with individual accounts. In his simulations, people who grew up in the top rung (\$455,000 and up) have a

74% chance of retiring with at least that much money under a system of individual accounts, compared with only a 40% chance under the status quo.

By James Mehr

MINERALS ALONE CAN'T CUT IT

Poor nations should diversify

In the first decades after World War II, economists believed that poor nations blessed with mineral resources should focus on developing them. Yet a new study shows that countries that depend on commodity exports, such as oil, have higher poverty rates and worse health conditions than nations with more diverse economies that have similar capita incomes.

Oil-rich Nigeria, for example, has a child malnutrition rate of 38%, compared with a worldwide average of 27%, notes Michael Ross, assistant professor of political science at the University of California at Los Angeles, who wrote the study on behalf of Oxfam America, an antipoverty group. Similar figures are evident in U.N. data—not part of Ross' study—that show that heavy dependence on "primary exports"—oil, minerals, and food—is correlated with higher mortality for children under 5 (table).

Ross says that exports of oil and minerals don't benefit the poor because profits go mainly to skilled workers in the extractive industries and to government officials. The study, built on research by Jeffrey D. Sachs and Andrew M. Warner of Harvard University, says the World Bank should encourage countries to diversify exports, improve the living conditions of the poor, and behave democratically. He says nations that are at least partly democratic, such as Botswana, Chile, and Malaysia, have "successfully used resource revenues to alleviate poverty."

Ross' study was released in anticipation of the Oct. 29 launch of the World Bank's review of its activities in mining and drilling. The World Bank will issue its review findings next June.

By Laura Cohn

EARLY DEATH IN COMMODITY ECONOMIES

Primary commodity exports as a share of all exports*	Mortality rate under age 5 per 1,000 live births
LOW	95
AVERAGE	93
HIGH	12

*Primary commodities include minerals, oil, a food. Based on sample 24 low- and middle-income countries
Data: U.N., *Business*

JAMES C. COOPER & KATHLEEN MADIGAN

CORPORATE AMERICA'S DOUBLE BLOW: SAGGING DEMAND, RISING COSTS

Heavy security expenses could prolong the profits recession

U.S. ECONOMY

The new era of uncertainty and heightened security in the wake of the September 11 attacks and the ongoing anti-terrorism scare continue to dim economic prospects. That's especially true for the bottom line of Corporate America, where the profits recession is sure to be longer and more severe than previously expected.

Profits were already in trouble before September. *BusinessWeek's* own preliminary tally shows that earnings plunged 54% from a year ago with no growth venues (page 44). Now, companies face a new lay-off costs and distribution problems on top of a better-than-expected drop-off in demand. Profit margins are under the most intense pressure since the 1991 recession, says a recent survey by the National Association for Business Economics (chart). Many businesses are warning that profits may not start heading higher until the third quarter of 2002.

THE MARGIN SQUEEZE MAY GET WORSE



consumer and capital spending. And it won't be only static profits that sag. The global recession means that overseas earnings will get hit, too.

UNTAINLY, REVENUES WILL SUFFER because the drop in demand will last longer than expected. The Commerce Dept.'s first look at third-quarter real gross domestic product, on Oct. 31, will show that consumer demand posted little if any growth, while capital spending continued to shrink at a double-digit pace.

Overall domestic demand is set to fall sharply in the fourth quarter. Given the weakness in orders, the drop in capital spending is likely to last well into 2002. While daily retail reports suggest that consumers are heading to shopping malls and car lots, they won't be buying with the same gusto of a year ago. That means spending during retailers' crucial holiday season could be dismal for both sales and profits.

Amid weak demand, most companies can't mark up prices. For the year ended in September, consumer inflation stood at a 10-month low of 2.6%. Goods prices are virtually flat, while service inflation has slowed from its recent high of midyear (chart).

If anything, companies are cutting prices, not raising them. It's the only way to generate business. Vehicle sales are holding up because Detroit is offering generous incentives, likely at the expense of future sales. Hotels and resorts are filling rooms by cutting rates. Deals like that help the inflation outlook, but they are a disaster for profits.

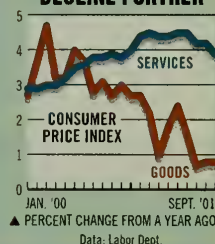
The Federal Reserve took note of the economic effects of the attacks in its Oct. 24 Beige Book. That report contains anecdotal soundings on economic activity from around the nation since September 11. The Fed said, "Business activity recovered quickly from some aspects of the shock, ... but longer-run effects are more difficult to assess." In particular, the bank noted retail sales and manufacturing were weaker in early October than they had been in August. Both sectors are more pessimistic about future sales and orders.

GOOD MANAGERS, HOWEVER, have long understood how to deal with sagging demand. A more uncertain part of the profit equation is on the cost side. Prior to September 11, companies were ready to enjoy a pared-down cost structure thanks to lower commodity and energy prices, cheaper borrowing costs, and slower wage growth. Those prospects haven't changed.

What is different is the rash of unexpected expenses companies now face because of the threat of terrorism. The Fed's report also noted that supply disruptions had temporarily affected output in certain industries. Likewise, the NABE survey shows that a significant portion of its members are concerned about how September 11 will affect their companies' daily business activities. Two-thirds of those surveyed expected no disruptions or that they would be short-lived. But a large 37% expected the effects to last until the end of 2001.

The survey was taken before the discovery of anthrax in Washington and Trenton, N.J., which now threatens to disrupt or delay mail service. The NABE

INFLATION IS SET TO DECLINE FURTHER



survey said the main effects would be costlier security measures, travel disruptions, increased insurance costs, and personnel-related productivity losses.

Safety precautions mean getting goods and people from point A to point B will cost more and take longer. Already, the threat of anthrax is slowing some mail deliveries. Security checkpoints at airports and inspections of trucks crossing borders, bridges, and tunnels also hamper the easy movement of passengers and supplies.

Those delays may impel companies to build up precautionary inventories as a safeguard against distribution disruptions. In the very short run, this could help real GDP growth, since the drawdown of inventories was a large drag on economic growth in the first half. Increased stockpiling in the fourth quarter may help cushion the weakness in output, but carrying those extra goods will add to the cost of doing business.

Finally, extra security and rising insurance premiums will lift expenses further. Of course, businesses shell out money all the time. But what makes these post-September 11 costs different is that they do not generate any additional revenue for the companies incurring them, nor do they have the potential to lift productivity as would, say, a new computer system.

IN ADDITION, CORPORATE AMERICA is unlikely to get any relief from overseas operations. Weak global demand will hurt exports, and a still-strong dollar means

that money made by foreign subsidiaries will lose value when translated into dollar figures. The trade-weight dollar has actually risen a bit since September 11, and is 2.4% ahead of its year-ago level.

Because of new security precautions, however, foreign trade may wind up being a positive for the economy in the very near term. A sharp narrowing in the August trade deficit suggests that net exports were a big plus in third-quarter real GDP growth. In the fourth quarter, imports may be facing a tougher time entering the U.S. than exports face going out.

However, exports are already falling faster than imports (chart). By early 2002, weaker global growth will hit exports even harder, likely reversing any near-term narrowing in the trade gap, adding further downward pressure to economic growth and profits.

In just six weeks' time, it has become a cliché to say so, but this truly is a new world. U.S. companies are reacting on the fly as best they can, added costs are clearly a burden on earnings. While dollar losses may pale next to the human tragedy, the severity of the profits recession will play a key role in the strength and shape of the U.S. economic recovery in 2002.



ITALY

THESE BUDGET NUMBERS ARE A PIPE DREAM

The Italian government's budget outlook was not good prior to the terrorist attacks in the U.S. Now, it's even worse.

The center-right government of Silvio Berlusconi presented its draft budget for 2002 in early October, projecting that the 2001 deficit would be 1.1% of gross domestic product, greater than its 0.8% goal. It stuck to its 2002 target of 0.5%. Most private economists say that's a pipe dream.

While the government's projection for economic growth this year of 2% is close to the general expectation, its forecast for next year, 2.3%, could well be more than a percentage point too high.

The economy stagnated in the second quarter as the global slowdown hit exports and manufacturing, even as consumer spending picked up. Now, global fallout from the U.S. slump will wield a

further blow to foreign demand, and the already visible weakening in the labor markets will intensify, depressing consumer spending. For example, in early October, Fiat announced sharp production cutbacks and layoffs totaling 20,000 workers.

Budget forecasts are a moving target, since government numbers are sketchy. But based on the latest blueprint, analysts at J.P. Morgan Chase & Co. think the 2001 deficit could hit 2.3% of GDP,

and the 2002 gap could touch 2.5%, unless the government goes forward with plans to sell a large amount of public real estate. Even then, the deficit would far exceed the 0.5% target. Moreover, Italy pledged to the European Union to balance its budget by 2003 would be practically impossible.

Berlusconi could land in hot water at home, too. The 2002 draft budget does not include any of the 30 billion euros (\$27 billion) income tax cuts he promised during last May's election. It does, however, include spending cuts aimed at containing the deficit. The government has said that it may add the tax cuts to the final budget document, but only if the EU loosens next year's budget goals. Either way, Italy once again appears to be digging itself into a fiscal hole.





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PRODUCTIVITY THE REAL STORY

Its growth is strong, and many of the New Economy gains will survive

Guns or butter? Security or consumption? That's a choice the U.S. hasn't faced since the cold war ended more than a decade ago. During the 1990s, it seemed the tech-fueled economy would grow so fast that the U.S. could afford both rising consumption and whatever defense spending was deemed necessary. And firing up much of that growth was a sharp rise in productivity: From 1995 to 2000, productivity growth averaged 2.5% annually, about a percentage point higher than the 1.4% productivity pace from 1975 to 1995.

There's little doubt that at least some of the productivity gains of the late 1990s are turning out to be short-lived. The dot-com boom and the stock market bubble of 1999 and early 2000 clearly overstated the strength of the economy and the size of its efficiency gains. Moreover, falling profits and tight capital markets have companies cutting back on capital spending, which will slow productivity gains. And the specter of terrorism is effectively imposing a tax on companies, forcing them to build up inventories and spend more on security. That, too, will be a drag on productivity, at least for a time.

Yet despite these changes, the factors that helped propel the productivity boom of the 1990s are not likely to disappear. The economy remains far more globalized and market-oriented than it was 10 or 15 years ago. Exports and imports are now about 24% of gross domestic product, and it would take repeated disasters to knock them down to the 19% share that prevailed during the slow-growth period from 1975 to 1995. Expected increases in defense outlays and recovery assistance

should leave government spending on goods and services less than 19% of GDP, still well below the level of the previous two decades. And even business investment, while weaker than it was during the tech splurge, is expected to stay substantially higher than it had been earlier.

The downturn is also forcing companies to tighten their operations and reorganize in ways unthinkable during the good times. That means layoffs and consolidations, but it also includes taking advantage of the best ideas from rivals to cut costs. "What happens in a recession is competitive intensity increases," says Bill Lewis, director of McKinsey Global Institute, which recently published a new study on productivity. Such measures could help counteract the terrorism-related hit to productivity.

"BETTER THAN IT WAS." Indeed, there's growing consensus among many economists that the U.S. can now sustain productivity growth of about 2% annually. That's below the super-charged productivity rates of the late 1990s. But the good news is that 2% is faster than the sluggish years of the 1970s and 1980s. "That's better than it was before the boom," says Cynthia Latta, chief U.S. economist at DRI-WEFA, which is forecasting a long-term productivity growth rate of around 2%. Indeed, that's almost exactly the long-term historical productivity growth rate of the past 50 years.

The same result was found by the McKinsey study, which looked at the productivity experience of individual industries rather than macroeconomic data. McKinsey concluded that roughly half of the productivity gains of the New Economy boom are clearly

WHERE PRODUCTIVITY GOES FROM HERE

BAD NEWS Productivity grew at a strong 2.5% rate in the late 1990s, fueling the economy's 4.1% growth rate. Now, the combination of the tech meltdown, slowing globalization, and the need to divert resources to government to pay for stepped-up defense and security means that sustainable productivity growth will fall to only about 2%.

GOOD NEWS Even at 2%, productivity growth will remain far above the 1.4% the U.S. posted during the slow years of the 1970s and '80s. It now appears to be returning to long-term historical average. And though the factors driving productivity growth, such as high levels of investment and trade, have slipped from recent years, they remain well above historic levels.

inable. That likely puts the expected productivity growth at around 2% or so over the next five years. Similarly, within the Federal Reserve, policymakers from Chairman Alan Greenspan on down are convinced that the productivity pickup is real and will continue, though perhaps at rates that prevailed in the late 1990s. Some top officials at the central bank say in private that annual productivity growth from here on out will be roughly 2%. Greenspan, for his part, seems certain that there are plenty of efficiencies to be gained from the further application of information technology. But like some of his central bank colleagues, he seems unsure whether the resulting productivity growth will be up to supercharged standards set in the late '90s.

Even Robert J. Gordon of Northwestern University, the leading skeptic of the New Economy, has acknowledged some productivity improvements. In an April, 2001, paper, he found that underlying "structural" labor productivity growth had jumped by 0.9 percentage points in the second half of the 1990s. Subsequent revisions of the data knocked that gain down to about 0.5 percentage points, in line with the consensus view. But Gordon cautions strongly that all of the productivity improvements came from the rising use and production of computers. Thus, in his view, if the tech slump continues, much of the productivity growth gains would evaporate.

The debate over where exactly productivity stands is of far more than theoretical importance. Suppose output per worker does grow at 2% a year rather than the 1.4% that prevailed from 1975 to 1995. If the labor force grows at about 1% annually, the shift up in productivity implies that gross domestic product can be expected to grow at about 3% rather than 2.4%. That extra half-percentage point or so of growth has tremendous advantages for the economy. It would provide an extra \$3 trillion in output over the next 10 years, in current dollars. That's enough to pay for both guns and butter.

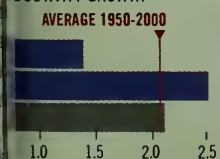
THE COST OF TERROR. Of course, there's no denying that the terrorist attacks and their aftermath are taking a toll on the economy and will continue to do so for some time. Inventory costs are up, and supply chains are slowing as companies that reaped such benefits of the information revolution as just-in-time inventory controls now must stockpile parts to prevent supply disruption. Others are spending on redundant and expensive computer backup systems. All are getting hit with higher insurance premiums.

And there's always the possibility that additional terror attacks or an expansion of the war will further erode the foundations of the productivity gains. If investors become permanently wary of taking risks, business investment could sink much further than anyone expects now. Terrorism and war could impose an even bigger cost on foreign commerce than is now expected and force a retreat from globalization. That is clearly weighing on Greenspan. "If we allow terrorism to undermine our freedom of action, we could reverse at least part of the palpable gains achieved by postwar globalization," he said in a speech at the



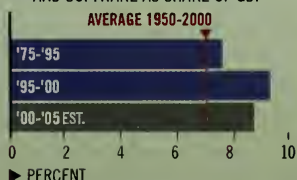
ACTIVITY WILL RETURN TO HISTORICAL LEVELS...

AVERAGE ANNUAL PRODUCTIVITY GROWTH



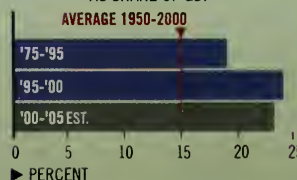
...AS INVESTMENT STAYS STRONG...

BUSINESS SPENDING ON EQUIPMENT AND SOFTWARE AS SHARE OF GDP



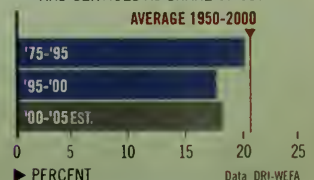
...THE U.S. REMAINS AN OPEN ECONOMY...

EXPORTS PLUS IMPORTS AS SHARE OF GDP



...AND GOVERNMENT'S ROLE REMAINS IN CHECK

GOVERNMENT SPENDING ON GOODS AND SERVICES AS SHARE OF GDP



Institute for International Economics, a think tank in Washington, D.C. Moreover, a bigger, longer war could mean a big jump in government spending—which would mean either higher taxes or bigger budget deficits and higher interest rates. Neither would be good for private-sector growth.

Still, Greenspan, for one, appears optimistic that Terrible Tuesday won't have a lasting effect on long-run productivity growth. There will be a sharp one-time hit to productivity in response to the attacks. But once companies and investors adjust to the reality of a riskier world—a process Greenspan concedes could take six months or more—productivity growth should pick up again. To Greenspan's way of thinking, the extra efficiencies yet to be reaped from information technology haven't gone away—they've just been set back.

Indeed, even after an 18-month tech slump, business investment in tech equipment and software is still substantially higher, as a share of GDP, than it was at the beginning of the 1990s, and companies are still using information technology to cut costs and revamp operations. Over the past 12 months, Office Depot Inc. has installed error-reducing scanners at 25 North American warehouses that serve online and catalog customers. That has helped cut operating costs at its business-services group by 1%, and the retailer hopes to triple those gains over the next three years.

TECH BOOST. In coming months, companies are sure to find new ways to better deploy their existing IT assets. The McKinsey report found that roughly half of the efficiency gains of the late 1990s were made in retailing and wholesaling. In these industries, higher productivity came from combining information-technology investment with basics such as building bigger stores and warehouses to take advantage of economies of scale and shifting to more efficient ways of organizing distribution. There's no reason why such improvements can't continue even if the tech-investment slump persists.

Indeed, productivity has surprised economists many times before, and there's at least a chance that productivity gains will exceed 2%. For one, the recession will put pressure on companies that grew fat in the boom years to get leaner. "When the economy was growing, there were revenue opportunities that covered a lot of sins," says Robert A. Eckert, chairman and CEO of Mattel Inc., the world's largest toy-maker. "Now, it becomes even more important to focus on productivity." By cutting its workforce, closing a factory, and taking steps to reduce product-development times, Mattel was recently able to report a 19% increase in earnings, before special charges, despite a sales increase of only 2%.

Moreover, the combination of deregulation and the merger wave of recent years has produced large competitors that take advantage of economies of scale. The banking industry went through massive mergers in the 1990s as regulatory barriers to interstate banking fell. That didn't immediately show up as increased productivity, according to McKinsey's analysis, since the big banks had to digest their purchases.

That's changing now as banks trim down and jettison unprofitable businesses. "Banks in general, as an industry, will increase productivity," argues James Dimon, CEO of Bank One Corp.

PRODUCTIVITY WINNERS, PAST...

Driven by info tech, economies of scale, and competitive pressures, six industries accounted for most of the jump in productivity growth in the second half of the 1990s.



DISCOUNTERS thrived

SHARE OF PRODUCTIVITY GROWTH
INCREASE 1995-1999

WHOLESALE TRADE	27.8%
RETAIL TRADE	25.6%
SECURITIES	18.8%
ELECTRICAL EQUIPMENT*	12.8%
INDUSTRIAL EQUIPMENT**	9.0%
TELECOM SERVICES	5.3%
OTHER	0.8%

*Mainly semiconductors **Mainly computers



TECH was a leader

...AND IN THE FUTURE

Industries with the potential to exploit information technology and economies of scale to obtain big jumps in productivity:

BANKING
CREDIT-CARD SERVICING
MEDIA
MORTGAGE BANKING
SOFTWARE



UTILITIES look like a good bet

Industries where regulatory changes could lead to more competition and a boost in productivity:

INSURANCE
PHARMACEUTICALS
MANUFACTURING
UTILITIES

Data: McKinsey Global Institute

One Corp. "In financial services, including banking, the mass project is to consolidate back-office software systems and eliminate the duplications." Bank One has lopped some 8,000 jobs since Dimon came on board in March, 2000. The resulting reduction means the bank now has just 46.9¢ in noninterest expenses for every dollar of income, a 14% decline since 2000.

And productivity gains may well spread to new areas of economy. The McKinsey study argues that innovation, economies of scale could bring productivity gains in industries such as health care, media, movie-making, and software. Meanwhile, deregulation will force productivity gains in industries such as utilities, long a laggard. The coming years will not be easy ones. But the boom of the 1990s established the foundation for more productivity growth in the years ahead.

By Michael J. Mandel in New York and Rich Miller in Washington, with Joseph Weber in Chicago, Christopher Palmeri in Los Angeles, and Aiza M. Pascual in Atlanta

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WASHINGTON POSTAL WORKERS HEAD FOR ANTHRAX TESTS: *Bacteria can quickly become resistant to today's antibiotics.*

COMMENTARY

By Amy Barrett

HOW TO GET PHARMA'S BIG GUNS AIMED AT MICROBES

The recent anthrax attacks have done more than frighten already anxious Americans. They have created confusion in the public health ranks over how to identify and treat people at risk. They have also triggered deep fears that we may run out of antibiotics just when we need them most. And with people in Canada and the U.S. recently pressuring their governments to override Bayer's patent on the antibiotic Cipro, the very stability of the drug patent system may be in question.

This reality highlights an imperative in medical research: More must be done to stimulate development of new antibiotics. Despite the bioterrorist threat and the ongoing battle being waged in the nation's hospitals against drug-resistant microbes, antibiotics remain a relatively low priority in many drug companies—mainly because they don't produce the lush profits that Big Pharma demands. "You have a huge science-based industry that is not aimed properly [at this problem]," says Martin Rosenberg, retired head of antibiotic discovery at GlaxoSmithKline PLC. "The government simply must put the right carrot in front of the companies."

Economics are at the heart of this problem. For one

thing, these drugs are typically administered for just a few days. Compare that to lucrative blockbusters, such as cholesterol-lowering medicines, that are taken daily for years. In addition, compounds that are effective against drug-resistant bugs are often used sparingly. That's because widespread use of antibiotics accelerates the evolution of resistant strains. But while holding powerful antibiotics in reserve makes sense, those drugs are often less profitable. "Market forces aren't in the right direction for antibiotic development, relative to other classes of

drugs," says Dr. David C. Hooper, of the infection control unit at Massachusetts General Hospital.

Despite those economic obstacles, technologies gave antibiotic research a big boost in the 1990s. A number of companies stepped up their efforts, using gene-based techniques to identify proteins in bugs that could serve as drug targets. But researchers are concerned that some of that momentum may be waning. Dr. Gail H. Cassone, president of infectious disease research at Eli Lilly & Co., says developing effective antibiotics against these new targets "is becoming more of a challenge than it once was appreciated." True, Lilly is expanding its efforts against infectious diseases in general, including antivirals and drugs aimed at blocking the disease-causing effects of bacteria. But the company has pared spending on new antibiotics that are the bugs.

That's unfortunate, because the need for new antibiotics has never been greater. For one thing, bacteria evolve much faster than going through the equivalent of one human generation in less than 30 minutes. And resistance genes are often swapped by different bacteria. As a result, *Staphylococcus aureus*, for example—a major cause of hospital-acquired infections—

BETTER ANTIBIOTICS

What's needed to get drug companies to make the necessary compounds:

REWARD DISCOVERY

Create more partnerships between the government and drug companies, with public funding for promising early-stage research.

DON'T OVER-REGULATE

Scrutinize all new FDA rules to make sure they don't discourage spending on antibiotics R&D in the future.

IMPROVE THE ECONOMICS

When new antibiotics must be used sparingly to fight drug-resistant bugs, extend patent life to compensate companies and encourage them to invest in the future.

PROTECT THE PATENTS

Avoid violating the patents on essential drugs such as Cipro. Such violations should only be sanctioned if supplies are inadequate and alternatives don't exist.



signs it may be developing resistance to the powerful drug vancomycin. It would be relatively easy for some microbiology expertise to cultivate a cipro-resistant strain of anthrax, says Gigi Kwik, a fellow at the Center for Global Biodefense Studies. "To build a good defense against bioterrorism," says Cassell, "you need a steady stream of [medical] innovations, particularly in the area of antibiotics."

CARROT. The government has been reluctant to make this happen. Agencies like the National Institutes of Health and the Defense Advanced Research Projects Agency have provided some research funding to companies to attack diseases and to test market potential. More money would be funneled to such projects, encouraging pharmaceutical companies to develop more effective drugs that will stand up to such threats as plague or anthrax, as well as more common problems like strep infections.

Financial incentives could also spur drug companies. One possibility is to extend patent life for antibiotics. It would be reserved for only the most serious infections. But any such patent extension for these restricted compounds would include steps to close other legal loopholes that drug companies exploit. Currently, drugmakers should not be allowed to delay generic competition for more than 12 months, which they have had ample time to recoup their costs. And the Food and Drug Administration should look for ways to streamline the process for antibiotic approval. The agency should be given the authority to make sure it isn't unintentionally dampening antibiotic development.

These steps, however, could be undermined if drug companies don't have a strong voice in the strength of their patents. Canada has reversed an earlier decision to override the Cipro patent, but the U.S. government. In the future, any move to override patents must first be vetted by an independent body that can determine whether alternative treatments exist. The imputed costs of Cipro didn't justify Canada's decision, since other antibiotics are available against anthrax.

Drugmakers believe their patents are being violated with little warning, that's why yet another strike against developing new antibiotics. And the public should be afforded that, considering how the war against anthrax is rising in the war against anthrax.

With John Carey in Washington

CIPRO: NOW FOR THE DOWNSIDE

With overuse, the anthrax cure will lose its effectiveness

With the toll from anthrax mounting, the antibiotic most commonly used to tackle the deadly bug is now a celebrity. News anchor Tom Brokaw recently held a bottle up to the camera, saying: "In Cipro we trust."

Sadly, that trust could be short-lived. Cipro "may have the dubious distinction of being the antibiotic we destroy faster than any other," warns microbiologist Abigail A. Salyers at the University of Illinois. The problem is that bacteria are immensely adaptable critters. Expose them to antibiotics long enough, and they'll evolve ways to survive the drugs.

Infectious-disease experts stress that people exposed to anthrax, such as postal workers in affected mail centers, should take Cipro, at least until tests show either that they don't have the bug or that their bacterial strain is susceptible to other drugs. But those who gulp down Cipro merely out of fear are being dangerously irresponsible, putting both themselves and others at risk.

Why? The human body teems with bacteria. A broad-based antibiotic such as Cipro acts like a neutron bomb on this ecosystem, wiping out billions of microbes. Not only can that impair normal body functions in which bacteria play a role, such as digestion, but harmful germs can move in, like squatters taking over suddenly vacant houses.

CRYING WOLF. Worse, antibiotics breed resistance. When you take a drug, the hardest bacteria among constantly mutating strains survive, reproduce, and pass along defense mechanisms against drugs. Taking Cipro for weeks "is the perfect situation for the regular bacteria in the body to become resistant," says Dr. Carol J. Baker, a pediatrician at Baylor College of Medicine and president of the Infectious Diseases Society of America. Except in the case of an actual anthrax infection—rather than mere exposure—it's best to take the antibiotic for a few days only, to limit the development of resistance in the body's bacteria.

Even without resistance, these normally harmless bugs can turn nasty.

Painful infections result when benign gut flora, such as *E. coli*, find their way to the urinary tract. *Streptococcus* bugs that live harmlessly in the throat cause pneumonia if they get into the lungs. Contract one of these diseases, and your doctor may prescribe Cipro. But if you've previously taken weeks of the antibiotic, your particular bug may already be primed to resist it. Not until you have to rush to the hospital will anyone know that something has gone horribly wrong. And the resistant microbes can spread to others.

Indeed, antibiotic resistance is one of the world's most pressing public-health problems. A single case of so-called multidrug-resistant tuberculosis costs more than \$250,000 to cure—and the deadly germs are on the rise in many countries. Up to 30% of bacteria that cause ear infections and pneumonia in



LESS PUNCH Antibiotic resistance is a pressing public-health problem

CIPRO: READILY AVAILABLE IN MEXICO

the U.S. can fight off standard antibiotics. The toll: thousands of hospitalizations and billions of dollars a year.

The quinolone drugs—of which Cipro is one example—were once part of the solution. They kill a wide spectrum of bugs, including strains resistant to other drugs. But resistance to quinolones has appeared in everything from meningitis-causing pneumococcus bugs to the *E. coli* in bladder infections.

It could get worse. Consider China, where quinolones have been widely overused for 10 years. The percentage of resistant *E. coli*, for one, has shot past 50%, rendering the whole class of drugs almost useless. "Unless we use Cipro wisely," says Dr. Stuart B. Levy of Tufts University, "we may lose one of the most important drugs we have."

By John Carey in Washington

BIOTERRORISM

KILLER TESTS FOR DEADLY GERMS

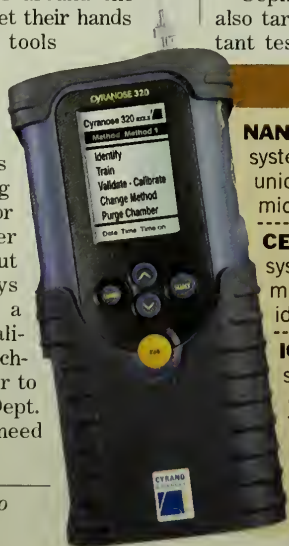
Fast, portable disease diagnostics are on the way

Imagine a scenario in which, instead of waiting 24 hours to hear back from a lab about possible exposure to bioweapons, you could get an answer in minutes. The test wouldn't just be for exposure to anthrax, either. It would encompass several deadly pathogens simultaneously. Now suppose the entire procedure took place on a personal computerlike device small enough to be carted onto a battlefield, or to government buildings, post offices, or schools.

This diagnostic utopia is the shared dream of a number of small companies that have recently been thrust into the spotlight. On Oct. 12, IGEN International Inc. of Gaithersburg, Md., announced that it would step up its joint research with the U.S. Army to develop systems that can quickly detect toxins in food, air, and water. Two California companies working on DNA-based tests, Cepheid and Nanogen Inc., are also being backed by the military. Others that have demonstrated rapid diagnostic systems—such as Idaho Technology and Bruker Daltonics Inc.—are also refining their germ-warfare wares.

FINDING ALTERED GERMS. None of these companies has a device that can address all of America's diagnostic needs. But experts in this area are confident that within a year or two, doctors around the U.S. could start to get their hands on a generation of tools that will provide faster, sharper portraits of disease threats facing the nation. "The vision is to create something like a smoke detector or handheld computer that you can send out into the field," says Steven E. Koonin, a professor at the California Institute of Technology and an adviser to the U.S. Defense Dept. "There is a great need for that."

BIO-SNIFFER: Cyrano Sciences' 320 model



The approaches to diagnostics are as varied as the individual players. IGEN's technology uses chemicals and light to analyze DNA, proteins, and other biological material bearing the characteristic marks of specific pathogens. Cepheid's systems use a chemical method that amplifies DNA, so trace levels of biological agents can be detected. Nanogen employs a chip that uses electrical charges to help analyze genetic material. The hope is not only to pinpoint disease-causing agents but also to identify germs that have been altered, say, to resist certain antibiotics.

Some of the most exotic devices have attracted serious interest in military circles. Bruker Daltonics, for example, uses a chemical-analysis process known as mass spectrometry to identify biological agents in the air in as little as three minutes. Right now, the equipment fills a Humvee, and the bill for just one system runs about \$250,000. Still, on Sept. 18, the U.S. Army announced a \$10 million order for Bruker's analyzers.

Cepheid, IGEN, and Nanogen have also targeted the military as an important test market for top-of-the-line di-

MICROBE HUNTERS

NANOGEN Developing laptop-size systems that are able to detect unique electrical signatures of microbial DNA

CEPHEID Designed a chemical system that amplifies DNA of microbial agents for easier identification

IGEN INTERNATIONAL Has a system that spots toxins using chemicals and light

CYRANO SCIENCES Makes an artificial nose to sense chemicals and bacteria



CEPHEID GEAR: The military is signing up

agnostic systems that are fast and portable. While those systems are under development, all three companies have begun selling larger, slower versions to drug and biotech companies and various private labs. Nanogen, for example, sold seven of its \$160,000 systems in the third quarter alone, plus reagents and other materials—leading analysts to predict that the company will bring in \$13 million in revenues this year from \$11 million last year.

Some of the diagnostic prototypes have a Star Trek feel and may not be available as practical tools for several years. Cyrano Sciences Inc. is selling an artificial nose that can sniff out and contain microbes and may someday detect bioweapons. A scientific test at the University of Texas at Austin uses an artificial tongue that changes color when exposed to various toxins. A fundamental problem is that the number of molecules is extremely small, so you have to suck a cubic meter of air through something and catch every particle in there," says Dr. Dean Neikirk, a member of the artificial tongue team. "That's certainly a challenge," he says. But as the ripples of bioterror grow more sinister, even far-out solutions are to be encouraged.

By Arlene Weintraub in Los Angeles and Alex Salkewitz in New York

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CORPORATE PROFITS

NOW, PROFITS ARE IN FREE FALL

With the drop-off in consumer confidence, they may get worse

For all the gloom over the economy this summer, many Wall Street pros were holding out hope that the U.S. could avoid a recession. As recently as early September, they were still betting that key pillars could continue to hold the economy up. Homebuilders and some other cyclical industries that usually collapse first in a downturn were standing firm this time, thanks largely to six Fed rate cuts that bolstered demand.

September 11 changed all that. The economy plunged into a full-blown recession—and already weak corporate profits have gone into a broad free fall. How bad is it? *BusinessWeek's* flash-profits survey of 124 bellwether companies showed a 54% slide in third-quarter profits—the sharpest quarterly decline recorded in *BusinessWeek* profit surveys in more than a quarter-century. **"DEEPER AND LONGER."** Things are likely to get worse before they get better. Given the sharp drop-off in consumer confidence, most Wall Street forecasters have grown more pessimistic. Not only do they see fourth-quarter profits falling 20% more but it may take until third quarter 2002 before the economy recovers and profits start to head up again. Some companies, including Boeing Co., are warning that the start of their recoveries could be pushed into 2003. "It now looks like the profits recession will be deeper and longer than we anticipated," says Edward Yardeni, chief investment strategist for Deutsche Banc Alex. Brown.

Indeed, the falloff in consumer spending has completely tamped sales growth as well. Overall revenues are now expected to be flat in the quarter, down from 8% growth in the second quarter. Among those hit were 3M Corp., which reported a 7% drop in third-quarter sales, to \$3.97 billion. Worse, 3M officials

warn that revenues may fall 3% to 7% more in the fourth quarter. "This is really unprecedented in that there is nowhere to hide, other than our health-care business, these days," says 3M's chief financial officer, Robert J. Burgstahler.

The pain is shared broadly. Only one sector—health care—is poised to record growth in the third quarter. Pacifying the group is Pfizer Inc. Strong sales of its anticholesterol drug Lipitor boosted profits 52%, to \$2 billion.

TECH AGAIN. For the third quarter in a row, tech and telecommunications proved the biggest laggards. Much blame goes to Lucent Technologies Inc., which posted a \$7.3 billion loss, largely from restructuring charges. Meanwhile, falling sales and a price war with rival Advanced Micro Devices sent Intel Corp.'s profits tumbling 96%, to \$106 million.

Many interest-sensitive companies are also seeing business crumble. Bad loans sent profits at Bank of America Corp. down 54%. And even though a flood of rebates and cut-rate financing offers are helping Detroit move inventory, they're coming at a huge cost (page 46). Ford Motor Co. recorded a \$692 million loss, while General Motors Corp. saw profits sink 54%, to \$385 million. "We're poised to do well with market share," says GM Chief Financial Officer John M. Devine. Still, "that doesn't help us with profits in the short term."

What does it all mean? Charles L. Hill, director of research at First Call/Thomson Financial notes that if the profits drought stretches into next year, it would match the 1951-52 period as the only six-quarter downturn in modern history. That's a dubious distinction many executives would prefer to avoid.

By Dean Foust in Atlanta, with Michael Arndt in Chicago, David Welch in Detroit, and bureau reports

CURRENT QTR. SA
(MILLIONS)

INDUSTRIALS

403,812.1

ABBOTT LABORATORIES	4,181.2
AIR PRODUCTS & CHEMICALS ††	1,361.7
ALCOA	5,511.0
AMERICAN STANDARD	1,885.0
ARCHER DANIELS MIDLAND †	5,504.1

BETHLEHEM STEEL	825.4
BOEING	13,687.0
BRISTOL-MYERS SQUIBB	4,743.0
CATERPILLAR	5,056.0
COCA-COLA	5,397.0

COLGATE-PALMOLIVE	2,391.2
CONAGRA FOODS †	7,607.8
CONOCO	9,744.0
DELPHI AUTOMOTIVE SYSTEMS	6,229.0
DUPONT	5,641.0

EASTMAN KODAK	3,308.0
EXXON MOBIL	53,009.0
FORD MOTOR	36,552.0
GENERAL DYNAMICS	3,020.0
GENERAL ELECTRIC	29,468.0

GENERAL MOTORS	42,475.0
GEORGIA-PACIFIC GROUP	6,306.0
GILLETTE	2,362.0
HALLIBURTON	3,391.0
HONEYWELL INTL.	5,789.0

ILLINOIS TOOL WORKS	2,395.6
INTERNATIONAL PAPER	6,529.0
JOHNSON & JOHNSON	8,238.0
KIMBERLY-CLARK	3,710.0
KRAFT FOODS	8,056.0

LILLY (ELI)	2,874.4
MAYTAG	1,227.1
MERCK	11,919.6
MINNESOTA MINING & MFG.	3,967.0
NIKE †	2,613.7

NORTHROP GRUMMAN	3,605.0
PEPSICO	6,906.0
PFIZER	7,898.0
PHELPS DODGE	937.0
PHILIP MORRIS	18,111.0

R.J. REYNOLDS TOBACCO	2,273.0
RAYTHEON	3,961.0
SCHERING-PLOUGH	2,382.0
SCHLUMBERGER	3,624.4
TYCO INTERNATIONAL ††	10,014.8

UNITED TECHNOLOGIES	6,920.0
USX-MARATHON GROUP	8,502.0
USX-U.S. STEEL GROUP	1,645.0
VISTEON	3,722.0
WEYERHAEUSER	3,742.0

WHIRLPOOL	2,594.0
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SERVICES

195,703.9

ALLSTATE	7,173.0
AMERICAN EXPRESS	5,724.0
AMR	4,816.0
AOL TIME WARNER	9,320.0
BANK OF AMERICA	NA

BANK ONE	NA
BURLINGTON NORTHERN SANTA FE	2,343.0
CARDINAL HEALTH †	11,773.4
CARNIVAL	1,489.9
CENDANT	2,481.0

CITIGROUP	27,714.0
CNF	1,185.0



% CHG.	EST. EPS (8/16)	REPORTED EPS	DIFF.		CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	EST. EPS (8/16)	REPORTED EPS	DIFF.
-21	0.49	0.43	-0.06								
-4	0.44	0.40	-0.04	COSTCO WHOLESALE ††	11,134.6	+5	190.7	-5	0.40	0.41	+0.01
-31	0.54	0.68	+0.14	CSX	2,019.0	-1	100.0	+69	0.50	0.47	-0.03
-8	0.46	0.39	-0.07	DOW JONES	397.6	-21	16.7	NM	0.29	0.19	-0.10
+1	1.41	1.23	-0.18	EXPRESS SCRIPTS	2,349.8	+35	32.6	+31	0.42	0.40	-0.02
+20	0.14	0.20	+0.06	FAMILY DOLLAR STORES †††	920.8	+17	34.1	+12	0.20	0.20	—
NM	-0.80	-1.11*	-0.31	FEDEX †	5,037.0	+5	124.0	-27	0.31	0.41	+0.10
+7	0.93	0.80	-0.13	FLEETBOSTON FINANCIAL	NA	NA	766.0	-21	0.74	0.70	-0.04
+38	0.62	0.63	+0.01	GOLDMAN SACHS GROUP	7,360.0	-17	468.0	-43	0.90	0.87	-0.03
-5	0.62	0.59	-0.03	HCA	4,438.0	+8	256.0	+47	0.40	0.48	+0.08
+1	0.40	0.43	+0.03	J.P. MORGAN CHASE	NA	NA	449.0	-68	0.67	0.22	-0.45
+8	0.49	0.49	—	LEHMAN BROTHERS HOLDINGS	5,057.0	-31	309.0	-32	1.24	1.14	-0.10
+16	0.29	0.36	+0.07	MANPOWER	2,675.4	-5	37.1	-31	0.48	0.48	—
-43	0.75	0.64*	-0.11	MARRIOTT INTERNATIONAL	2,345.0	+2	101.0	-8	0.42	0.39	-0.03
-82	0.08	0.05	-0.03	MBNA	NA	NA	478.3	+30	0.52	0.54	+0.02
-75	0.14	0.13	-0.01	McDONALD'S	3,879.3	+3	545.5	-1	0.39	0.42	+0.03
-77	1.03	0.52*	-0.51	McGRAW-HILL	1,535.1	+10	239.5	+11	1.37	1.22	-0.15
-29	0.53	0.46	-0.07	MCKESSON †	12,159.3	+23	79.0	+28	0.31	0.27	-0.04
NM	0.27	-0.28	-0.55	MORGAN STANLEY DEAN WITTER	10,431.0	-11	735.0	-41	0.71	0.65	-0.06
-22	1.13	1.13	—	NEW YORK TIMES	696.9	-9	43.8	-40	0.39	0.28	-0.11
+3	0.36	0.33	-0.03	SAFEWAY	7,962.3	+7	309.2	+15	0.60	0.60	—
-54	0.83	0.85	+0.02	SCHWAB (CHARLES)	1,224.0	-27	13.0	-91	0.07	0.01	-0.06
NM	0.15	0.35*	+0.20	SEARS, ROEBUCK	9,753.0	+2	262.0	-6	0.80	0.80	—
-15	0.28	0.28	—	SOUTHWEST AIRLINES	1,335.1	-10	151.0	-18	0.20	0.19	-0.01
+39	0.42	0.42	—	SUPERVALU ††	4,715.3	-12	52.1	-9	0.36	0.39	+0.03
NM	0.53	0.44*	-0.09	SYSCO †	5,828.7	+9	164.0	+14	0.24	0.24	—
-25	0.70	0.65	-0.05	TRICON GLOBAL RESTAURANTS	1,640.0	-1	124.0	+110	0.80	0.81	+0.01
NM	0.10	0.14*	+0.04	UNION PACIFIC	3,026.0	-1	267.0	+4	1.06	1.04	-0.02
+16	0.48	0.49	+0.01	UNITED PARCEL SERVICE	7,481.0	+2	568.0	-19	0.53	0.50	-0.03
-5	0.85	0.79	-0.06	WALGREEN ††	6,283.6	+17	216.9	0	0.21	0.21	—
-8	NA	0.29	NA	WELLS FARGO	NA	NA	1,164.0	+42	0.69	0.67	-0.02
-25	0.67	0.54	-0.13	TECHNOLOGY	68,957.6	-20	-729.9	NM	0.17	0.08	-0.09
NM	0.41	0.45*	+0.04	APPLE COMPUTER ††	1,450.0	-22	66.0	-61	0.19	0.19	—
+6	0.83	0.84	+0.01	COMPAQ COMPUTER	7,476.0	-33	-499.0	NM	0.07	-0.07*	-0.14
-21	1.13	0.99	-0.14	COMPUTER ASSOCIATES INTL. ††	734.0	-52	-291.0	NM	0.53	0.61*	+0.08
-3	0.71	0.75	+0.04	EBAY	194.4	+71	18.8	+24	0.10	0.07	-0.03
-22	1.52	1.28	-0.24	EMC	1,212.3	-47	-945.2	NM	0.02	-0.12*	-0.14
-17	0.45	0.34	-0.11	GATEWAY	1,409.8	-45	-519.7	NM	-0.01	-0.17*	-0.16
+52	0.33	0.33	—	GENENTECH	523.7	+24	42.7	+642	0.19	0.08	-0.11
NM	-0.98	-1.28	-0.30	INTEL	6,545.0	-25	106.0	-96	0.10	0.02	-0.08
0	1.07	1.06	-0.01	IBM	20,428.0	-6	1,595.0	-19	0.99	0.90	-0.09
+9	1.30	1.31	+0.01	LEXMARK INTERNATIONAL	1,003.5	+8	70.0	+6	0.56	0.52	-0.04
NM	0.41	0.35	-0.06	MICROSOFT †	6,126.0	+6	1,283.0	-50	0.40	0.23	-0.17
+2	0.41	0.41	—	MOTOROLA	7,406.0	-22	-1,408.0	NM	-0.05	-0.07*	-0.02
-5	0.39	0.34	-0.05	ORACLE †	2,242.0	-1	510.6	+2	0.08	0.09	+0.01
-28	0.84	0.70	-0.14	SOLETRON †††	3,594.9	-24	-250.3	NM	0.07	-0.38	-0.45
+14	1.11	1.12	+0.01	SUN MICROSYSTEMS †	2,861.0	-43	-180.0	NM	0.02	-0.06	-0.08
+60	0.81	0.62	-0.19	TEXAS INSTRUMENTS	1,849.0	-41	-117.0	NM	-0.04	-0.07	-0.03
NM	-0.48	-0.28	+0.20	XEROX	3,902.0	-13	-212.0	NM	-0.04	-0.29	-0.25
NM	0.28	-0.57*	-0.85	UTILITIES & TELECOM	131,317.1	+12	-6,304.0	NM	0.26	0.28	0.02
-54	0.58	0.41	-0.17	AT&T	13,087.0	-8	-2,206.0	NM	0.04	0.04*	—
NM	1.46	1.46*	—	AT&T WIRELESS SERVICES	3,502.0	+25	77.0	+267	-0.02	0.03	+0.05
-25	0.52	0.45	-0.07	BELLSOUTH	6,013.0	-12	7.0	-99	0.59	0.59*	—
-65	0.65	0.32	-0.33	CONSOLIDATED EDISON	2,692.9	-5	280.7	-1	1.44	1.30	-0.14
-60	0.41	0.22	-0.19	DUKE ENERGY	16,718.0	+7	796.0	+3	0.78	1.01	+0.23
NM	-0.16	-2.68	-2.52	DYNEGY	8,519.0	+2	286.0	+22	0.81	0.85*	+0.04
NM	NA	-0.22	NA	EDISON INTERNATIONAL	4,043.5	+11	-407.2	NM	0.93	2.27*	+1.34
-54	1.26	1.28*	+0.02	ENRON	47,613.0	+59	-618.0	NM	0.43	0.43*	—
+30	0.63	0.64	+0.01	ENTERGY	2,575.7	-25	317.5	+4	1.17	1.39	+0.22
-13	0.62	0.58	-0.04	LUCENT TECHNOLOGIES †††	5,155.0	-28	-7,329.0	NM	-0.21	-0.27*	-0.06
+30	0.55	0.53	-0.02	SBC COMMUNICATIONS	11,338.0	-16	2,072.0	-31	0.60	0.61	+0.01
+25	0.80	0.84	+0.04	SOUTHERN	3,165.0	-1	554.0	+6	0.79	0.80	+0.01
-2	0.33	0.23	-0.10	SPRINT FON GROUP	4,244.0	-5	154.0	-60	0.28	0.18	-0.10
-9	0.75	0.61	-0.14	SPRINT PCS GROUP	2,651.0	+55	-288.0	NM	-0.22	-0.29	-0.07
NM	0.25	-0.21	-0.46								

† First-quarter results †† Second-quarter results ††† Fourth-quarter results NM = not meaningful NA = not available *EPS adjusted for special items

Data: Standard & Poor's COMPUSTAT; earnings estimate data provided by I/B/E/S, a division of Thomson Financial

AUTO MAKERS

SO MUCH FOR DETROIT'S CASH CUSHION

Acquisitions and stock buybacks have left carmakers strapped

Looks like hard times have really arrived for Detroit. True, U.S. auto sales have rebounded from their post-September 11 slump. They are now expected to top 16 million cars and trucks in 2001, making this one of the strongest years ever. But it took costly 0% financing to get sales out of the ditch. Such perks, along with slashed prices and bloated costs, have crushed third-quarter earnings for the Big Three, and they face an uphill battle to show profits in the quarters ahead.

What comes next could be even uglier: Analysts are projecting sales will fall off by at least a million vehicles next year—and the Big Three are heading into the downturn with cash reserves dropping sharply. If past recessions are any guide, that could mean problems. "They all had these huge cash reserves to weather the next crisis," says Christopher W. Cedergren, an auto consultant at Nextrend Inc. Now, "they don't have the financial ability to [develop] new product."

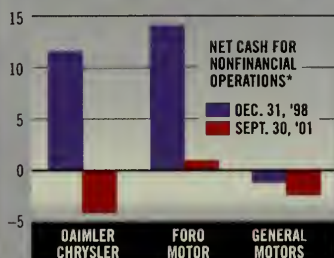
Of course, weak cash reserves in a downturn have always been the bane of the extremely cyclical auto industry. That's partly because of the huge fixed costs of running factories even through periods of low demand. But auto makers also need to build up enough liquidity to continue to fund the huge sums needed to come up with new models. During the recession of the early '90s, Merrill Lynch & Co. analyst John Casesa calculates that the Big Three burned through a whopping \$28 billion in cash.

BROKEN VOW. This time around, things were supposed to be different. Years of restructuring in the early '90s put Detroit's auto makers on far stronger financial footing, and all swore they would be prepared for the next downturn. As recently as late 1998, both Ford Motor Co. and Chrysler Corp. had big cash cushions in their auto units. Excluding debt and prepaid employee benefits, Ford boasted net cash of \$14 billion; Chrysler had \$11.5 billion. Only General Motors Corp.—where net cash was already at -\$1.2 billion—lagged.

With trouble now at the door, however, Detroit's piggy banks are again running low. In less than three years, the auto makers have drained nearly \$30 bil-



SHRINKING PIGGY BANKS



▲ BILLIONS OF DOLLARS

*NET CASH IS DEFINED AS CASH AND MARKETABLE SECURITIES MINUS DEBT AND EXCLUDING PREPAID EMPLOYEE BENEFITS.

Data: Company reports

lion in cash from their coffers. Ford added Volvo and Land Rover to its stable and paid out \$3.5 billion for the Firestone tire recall. GM bought into Fiat and Saab. Likewise, DaimlerChrysler took a stake in Mitsubishi Motors Corp. and lost a bundle on troubled operations.

Ford and GM, moreover, succumbed to investor pressure to return cash to shareholders through dividend increases and stock buybacks.

Now, shrinking profits caused by rising costs, big rebates, and 0% financing programs are making things worse. Ford lost \$692 million in the third quarter, while GM lost \$368 million; both earned over \$800 million for the year-ago quarter. DaimlerChrysler got hit, too. Its profit fell 70%, to \$821 million, in the third quarter, dragged down by Chrysler Group's \$243 million loss.

PAYING THE BILLS. Money is already scarce. Ford has just \$915 million in net cash. Merrill's Casesa estimates that if a downturn lasted three years, Ford could go through \$11 billion in cash in net losses, capital spending, and dividends. Domestic rivals are worse off: GM is now down to net cash of -\$2.3 billion. At DaimlerChrysler's industrial operations, net cash has dipped to -\$4.1 billion.

Of course, that doesn't mean the bills won't get paid. In a tight spot, Ford and GM can each tap several billion set aside in prepaid retiree benefits. All of the carmakers can hit the debt markets, too. Ford raised \$9.4 billion through bond sales on Oct. 22, although most will go to its financing arm.

Still, raising debt is getting pricier. One week earlier, Standard & Poor's cut bond ratings to BBB+ at GM and Ford. S&P is expected to cut DaimlerChrysler's

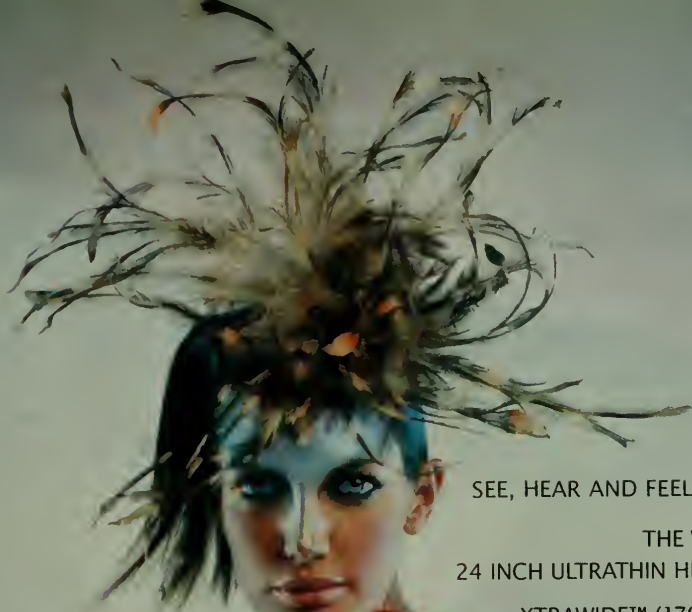
SALES FORCE: now paying almost a percentage point more in interest than last year.

Will the cash squeeze again force Motown to cut back on product development? In the recession a decade ago, high debt and faltering operations forced GM to delay a raft of new models. When sales took off again in 1992, GM was stuck with tired cars and a dearth of the newly popular SUVs. Rivals such as Ford grabbed market share with popular products like the Explorer.

That's an experience no carmaker wants to repeat. And Detroit already needs hot new cars and trucks to win back share from Asian and European rivals. With the cost of developing a new model now topping \$800 million, though, the Big Three may have no choice but to cut back. "You'll see a lot of vehicles that were [supposed to be] coming out in 2004 coming out later," says Michael Robinet, managing director of auto researcher CSM Forecasting. That's not likely to make the cash situation any better in the long run, either.

By Kathleen Kerwin, with Joann Muller and David Welch in Detroit

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ANTITRUST

WILL THE EU GO FOR MICROSOFT'S JUGULAR?

The software giant faces a broad legal assault from the EU

It was a lesson Bill Gates couldn't miss. Last summer, General Electric Co.'s John F. Welch flew to Brussels and lobbied for approval of a deal Washington had already O.K.'d, GE's \$42 billion merger with Honeywell International Inc. Yet by the time Welch emerged from his meeting with Europe's powerful Commissioner for Competition, Mario Monti, the merger was dead.

Now it's Gates's turn to deal with Monti. Just as Microsoft appears to be nearing the conclusion of its battle with Washington, the debate over its conduct is heating up in Europe, where the software giant pulls in one-third of its sales. By mid-November, Microsoft attorneys must respond to charges in Brussels that it is using its desktop dominance to steamroll a host of rivals in everything from server software to online music.

So how serious a threat does the software giant face? Chances are Monti will steer clear of any attempt to break up Microsoft or order it to release its precious source code, the digital foundation of its empire. But he could well force Microsoft to rip its Windows Media Player, the heart of its multimedia push, out of its operating system, or hit the company with a big fine.

The American and European cases are similar. Both focus on Microsoft's attempts to leverage its strength in desktop. But while the American case focused on the browser wars that raged in the mid-'90s, Monti is looking closely at servers. These powerful computers are at the core of Microsoft's .NET strategy, the giant's bid to extend its dominance from PCs to the entire networked world.

Monti issued preliminary findings in a confidential document in August, and announced that he would "make every

effort" to prevent "monopolization through illegal practices." Two days of closed-door hearings are scheduled for December—which means by February, Monti could well be in a position to rule on the case and impose whatever sanctions he deems needed. Here's a look at what could happen:



Gates faces an army of regulators headed by just one man: Commissioner Monti

■ **Microsoft Breakup.** It's a remote possibility, but EU officials insist they have the power to break up the company. But such a hardball tactic could spark a titanic struggle with Washington, since U.S. regulators shelved their breakup proposal two months ago. Moreover, it

would be seen as draconian, since Microsoft has yet to even defend itself against EU charges filed only weeks ago.

■ **Open the Source Code.** For now, a move to force Microsoft to release its source code also looks like a long shot. Opening the source code would enable competitors to clone Microsoft's Windows arsenal—a disaster for Redmond. But to Microsoft's relief, the words "source code" did not appear in Monti's statement of objections. What's more, many of Microsoft's rivals lobbying on both sides of the Atlantic aren't calling for a source-code remedy. Why? The code is so complex and convoluted that few appear eager to wrestle with it. "It's 30 million lines of spaghetti," says one rival lobbyist.

■ **Unbundle Windows.** Prospects appear greater that the EU may push Microsoft to take features out of Windows that compete with rival stand-alone products. The most likely: Windows Media Player, which competes with RealPlayer from RealNetworks Inc. Microsoft crushed Netscape Communications Corp., in part, by bundling the Internet Explorer browser with Windows.

■ **Insist on Access.** The commission also seems keen on pushing Microsoft to give rivals technical data they need to compete effectively with Redmond. That means timely disclosure of so-called application program interfaces, the hooks developers use to make programs work with Windows. Competitors have accused Microsoft of withholding APIs from rivals, so that developers from Microsoft or its partners can get products to market faster, or make them work better with Windows. Monti is likely to force Microsoft to disclose those APIs earlier.

■ **Levy a Big Fine.** The commission has the authority to impose a fine of up to 10% of annual sales. That could amount to \$2.5 billion—Microsoft's entire projected profit for the current year. Still, money means far less to it than market dominance. Moreover, few in Brussels believe the EU, which has never imposed a fine of more than \$100 million, would ask for anywhere near the maximum. That said, few believe Microsoft will walk away with a slap on the wrist, either.

By Stephen Baker with Renée Cordes in Brussels, Jim Kerstetter in San Mateo, and Jay Greene in Seattle

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In Business This Week

EDITED BY MONICA ROMAN

SEARS CUTS BACK IN ORDER TO GROW

SEARS ROEBUCK SAID ON OCT. 24 that it would cut 4,900 salaried jobs, or 15% of its workforce, by 2003. The cuts are part of a reorganization that aims to move Sears away from its department-store heritage and double retail profits. CEO Alan Lacy wants to capture the higher operating efficiencies enjoyed by rivals by offering more self-service and centralized checkout in its 860 full-line stores. Also in the works: plans to narrow Sears' apparel assortment, while building on its strength in home appliances, electronics, and tools.

THE FTC REFUSES A POTENT COCKTAIL

THE FEDERAL TRADE COMMISSION on Oct. 23 decided to block Diageo and Pernod in their effort to buy Vivendi's

wine and liquor division. The issue: rum. Vivendi's Seagram unit and Diageo are the No. 2 and No. 3 makers of rum, respectively. The FTC decided that the combo would make a potent, anticompetitive cocktail, even though their joint production would still trail industry leader Bacardi. The FTC has a long history of rejecting mergers when also-rans take on the leader. Last year, the agency rejected a merger between H.J. Heinz and Beech-Nut, the second- and third-largest makers of baby food, after Gerber. While nixing the Seagram deal, the FTC let through General Mills' purchase of Vivendi's Pillsbury unit.

STRONGER SUPPORT FOR STEEL QUOTAS

AMID THE DIN OF QUARTERLY losses and bankruptcies, the U.S. steel industry got some good news from the government. The International Trade Commission, acting on a request from President Bush, ruled on Oct. 22 that imports are hurting U.S. steelmakers. The move clears the way for Bush to impose quotas or duties on foreign steel in early 2002. But steel buyers warned they'll be the next to suffer. The Consuming Industries Trade Action Coalition claimed quotas could cost U.S. manufacturers nine jobs for every one saved in the steel industry. Foreign producers also complained they are losing market access and may appeal to the World Trade Organization.

A MAYTAG MAN GOES TO THE OLYMPICS

FORMER MAYTAG CHAIRMAN Lloyd Ward, 52, was named chief executive of the U.S. Olympic Committee on Oct. 21. The former Michigan State basketball captain fell from the Olympian heights at

HEADLINER: KENNETH LAY

THE SHOES ARE DROPPING

WHEN ENRON CEO JEFFREY Skilling resigned abruptly in August after six months on the job, longtime Chairman Kenneth Lay assured investors that "there's no other shoe to fall." So much for the warning. On Oct. 16, the Houston-based energy giant reported its first quarterly loss in more than four years after taking \$1.01 billion in write-offs. It also disclosed a surprising \$1.2 billion charge to shareholder equity to help unravel complex transactions between Enron and partnerships that until recently had been overseen by former



Chief Financial Officer Andrew Fastow. Then, on Oct. 22, Enron revealed that the Securities & Exchange Commission is probing those Fastow-related transactions. Two days later, Enron promoted Jeff McMahon to CFO and announced that Fastow will take a leave of absence. The setbacks have Lay, who has reclaimed the CEO post, scrambling. He must get operations back on track, fend off shareholder lawsuits, and, above all, rebuild credibility with investors.

*By Stephanie Anderson
Forest in Dallas*

Maytag in 1999. He later became the chief electronic-car salesman at iMotors.com, which went out of business earlier this year. USOC President Sandy Baldwin said the national organization, with a \$100 million annual budget, needs a marketer like Ward. After the 2002 Winter Olympics in Salt Lake City, there won't be another U.S.-based games until at least 2012. That means tough sledging for U.S. Olympic sports fund-raising and corporate sponsorships. So, this ex-Maytag repairman won't be idle.

THE TWIN TOWERS: TWIN ATTACKS?

WAS THE SEPTEMBER 11 attack on the World Trade Center one incident or two? The answer to that question could be worth billions of dollars to insurers or WTC leaseholder Larry Silverstein. On Oct. 22, Swiss Reinsurance

filed suit in Manhattan Federal Court, claiming the attacks were one orchestrated event that carries maximum insurance coverage of \$3.5 billion. Silverstein counters that each plane crash was a separate event, each carrying coverage, for a total of \$7 billion. As the largest insurer of the Twin Towers, Swiss Re is on the hook for 22% of the final amount. Its suit also claims Silverstein didn't purchase adequate insurance to replace the buildings and lost rental income.

ET CETERA...

- The Defense Dept. backed Northrop Grumman's bid to acquire Newport News Shipbuilding.
- Former GE head Jack Welch will advise J.P. Morgan Chase on leadership and other issues.
- Amazon.com cut holiday sales forecasts and lowered fourth-quarter sales estimates.

CLOSING BELL

SLEEPLESS

Pharmacia's shares tumbled 10%, to \$38.39, on Oct. 23 after the drugmaker said next year's results would be hurt by the loss of U.S. marketing rights to the insomnia drug Ambien. Weak farm economies in the U.S. and Latin America will also be a drag on the company's 85%-owned Monsanto agricultural unit.





*2 years
planning*

*9 months
waiting*

*10 years
in labor*

*18 years until we
get the house built*



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EDITED BY RICHARD S. DUNHAM

JUST WHEN THE RIGHT THOUGHT BIG GOVERNMENT WAS HISTORY...

Traumatized Americans now support increased defense spending, tough new anti-terrorism measures, and more domestic drilling to lessen reliance on imported oil. President Bush towers near a 90% job approval rating, and congressional Republicans have never been more popular. So why so many long faces on the Right?

Answer: Big Government is back, as Congress and the Bushies work together to prop up battered industries, extend benefits for dislocated workers, and help the public-health system cope with bio-terror. Bush sees this bipartisanship as the ultimate expression of the new one he wanted to bring to Washington. But true believers on the Right worry that Bush is ending too many conservative principles for the sake of consensus. "It's important that government protect its citizens," says Kenneth L. Connor of the socially conservative Family Research Council. "But that shouldn't be a pretext for growing government."

The restive Right fears that Bush will agree to hike funding for safety-net programs and build new bureaucracies such as the Office of Homeland Security. Conservatives also fret that Bush will sell them out on the House's \$100 billion economic stimulus package by tilting toward the Dems and ignoring demands for capital-gains tax cuts and business breaks. One would give almost \$6 billion to IBM, General Motors, Ford, and three other companies. Some Senate Dems are backing a \$70 billion plan that would promote business investment but also expand unemployment benefits and help pay for health insurance. There also is talk in both parties of bailouts for the insurance and travel industries. "We had just gotten things under control. Now we're about to go blow it all," says Paul Weyrich, president of the Free Congress Foundation.

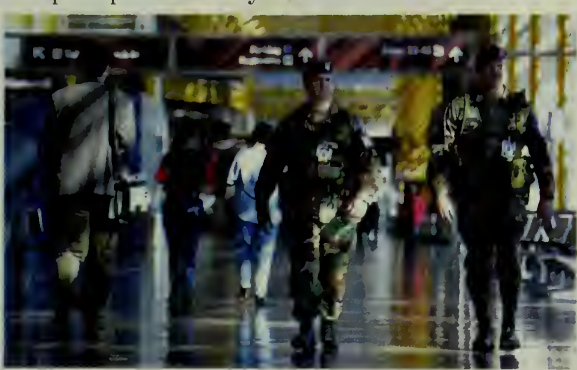
Are conservative fears misplaced? Maybe not. By 50% to 41%, Americans now say Washington should do more to solve the country's problems, according to an Oct. 5-6 CNN/USA Today/Gallup Poll. In a poll completed Sept. 10, the public said, 55% to 36%, that government was doing too much.

One flash point: a plan to federalize airport security, which passed the Senate 100-0. House Majority Leader Richard K. Armey (R-Tex.) says that would create 37,000 Democratic unionists. Conservatives have also linked hands with the Left

to tone down sweeping new law-enforcement powers in Bush's anti-terrorism bill (page 88).

"IRRESPONSIBLE." With Bush's approval rating sky-high, it is tough for right-wingers to criticize him directly. Instead, they are railing against new programs, such as an unlimited victims' assistance fund included in the \$15 billion airline bailout. "We've done some things that are grossly irresponsible," fumes Assistant Senate Minority Leader Don Nickles (R-Okla.).

To reduce the fallout, Bush has officially endorsed the



REAGAN NATIONAL: Airport security is a flash point

House stimulus plan, tamped down efforts to raise the minimum wage, and quashed New York's hopes for an additional \$56 billion. Treasury Secretary Paul H. O'Neill, who earlier had dismissed the House package as "show business," on Oct. 23 called the Democratic bill "a spending plan." And Office of Management & Budget Director Mitch Daniels warns: "We now face a great risk of runaway spending...and the erection of a much larger permanent federal government."

That's just the kind of tough rhetoric conservatives like to hear. But as Bush is forced to rely on Big Government remedies to soothe an anxious country, the rumble on the Right is likely to get louder.

By Lorraine Woellert, with Dan Carney and Amy Borrus

ON THE RECORD



On Oct. 18, correspondent Lorraine Woellert talked with ever-feisty conservative leader Tom DeLay, the House Majority Whip.

On post-September 11 spending:

People have concerns about what the hangover is going to look like. Come May or June, when people

wake up to huge [new] spending and we're getting close to going back into deficit spending, people are going to ask questions about what we did.... The President says in time of war we may have to go to deficit spending, but some of us are saying: "No."

On growing support for government:

You can't take five weeks and decide that everything has changed. Certainly, we are different than we were before

September 11. But I don't think basic philosophical values have changed.

On bipartisanship:

The Democrats' definition of bipartisanship is buy into my [plan] and I'll come on board.... I'm trying to support the President's position, and the press says I'm the guy blowing up bipartisanship. My definition of bipartisanship is: The President has a position. What will it take for you Democrats to support [that] position?

AUTOS

BMW: SPEEDING INTO A TIGHT TURN

Will its expanding line survive this economic skid?

At Bayerische Motoren Werke's Dingolfing factory just outside Munich, the stately new 7 Series sedans are rolling off the line, in time for a November debut. A remake of its predecessor, the new model features a powerful eight-cylinder engine, an all-aluminum chassis for a smoother ride, and air-cooled seats. Then there are the fun touches, such as a key that automatically adjusts the driver's seat and tunes the radio to a favorite station.

It's a tough time to be launching a car with a starting price likely to top \$65,000. But that's BMW's specialty: making Ultimate Driving Machines. And pushing a mix of luxury and high performance has delivered profits every year for the past 40, save one. The question is, can the Bavarian carmaker ride out this recession, which is weakening all of its main markets? It's up to BMW's understated CEO, Joachim Milberg, to make sure it can.

WHAT DOWNTURN? So far, BMW is on track. In September, when most auto makers suffered a big drop in their U.S. sales, BMW's actually rose 4%, bolstered by demand for the X5, a smooth-handling \$40,000-plus sport-utility vehicle that BMW's plant in Spartanburg, South Carolina, can't churn out fast enough. That compares with a 16% sales plunge for Porsche, a 12% drop for Toyota's Lexus, and a 9% drop for Mercedes-Benz. Even in the Northeast, where dealerships were deserted after the September 11 attacks, BMW reported few order cancellations.

An impressive performance. But is BMW big enough to go the distance? In today's global auto industry, most CEOs subscribe to the view that bigger is better. "History shows

that small players fall by the wayside," says Garel Rhys, professor of motor industry economics at Cardiff University in Wales. Heeding conventional wisdom, BMW tried to grow through acquisitions. But it admitted defeat when it unloaded Rover Group in 2000, just six years after buying the British carmaker. Family-controlled BMW could one day become a takeover target, since its output is only half the 2 million vehicle-a-year threshold considered a prerequisite for long-term survival.

The 58-year-old Milberg is still



BMW'S BRAIN DRAIN

A February, 1999, shakeout at the Bavarian auto maker has led to an exodus of management talent

BERND PISCHETSRIEDER The former BMW CEO now heads Volkswagen's Seat brand and is designated successor to CEO Ferdinand Piëch

CARL-PETER FORSTER The ex-BMW production chief now runs General Motors' Adam Opel subsidiary

WOLFGANG REITZLE The onetime head of development and purchasing at BMW oversees Ford Motor's Premier Automotive Group, which includes Aston Martin, Jaguar, and Volvo

WOLFGANG ZIEBART Reitzle's successor at BMW is now head of automotive systems at Continental Tire

Data: BusinessWeek

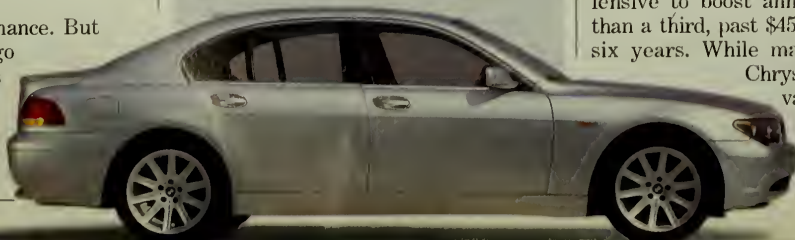
7 SERIES SEDAN

wagering that BMW will make it on its own. "Our strategy is to grow from our own strength," he says. He's not going the mass-market route. His predecessor, Bernd Pischetsrieder, tried that by buying Rover, a maker of dumpy middle-of-the-road sedans (the classy Land Rover off-track vehicles were just a fraction of sales). But Rover's losses ended up costing BMW \$3.6 billion. And Pischetsrieder? He quit.

So Milberg has taken BMW back to its roots. The German carmaker has embarked on one of the most aggressive product rollouts in its 85-year history. Every model will compete on quality, and technology—none on price. Adding to its traditional three-model lineup—the wedge-shaped \$27,745-plus 3 Series, the sleek 5 Series, which goes for \$36,595 and up, and the top-of-the-line 7 Series—BMW plans 20 new models. A 1 Series compact will feature rear-wheel drive, to ensure the same precise handling that characterizes its larger cars. It will roll out upscale 6 Series coupes and convertibles, and the X3, a smaller variant of the popular X5. Rounding out the portfolio are two legendary British marques: the cult Mini brand, a holdover from Rover, and Rolls-Royce, acquired in 1998.

BMW is counting on the product offensive to boost annual sales by more than a third, past \$45 billion, in the next six years. While margins at Daimler-

Chrysler have just about vanished, BMW's have climbed up to 9%, more than double the industry av-





MILBERG: "There's no reason for BMW to merge with anyone"

veiled earlier this year looked like the offspring of a one-night stand between Ford and Fiat. Ouch!

Though both projects were far along when Milberg took over, the worry is that the ex-professor lacks the brand savvy needed to preserve the BMW look. BMW officials know they risk ruffling customers by straying beyond the brand's conservative styling. "We have to expand the range of designs, and sometimes that hurts a bit," says Burkhard Göschel, director of research and development. But design blunders can be fatal for a small manufacturer. Warns Rhys: "If BMW ever made an error with its 3 Series, it would be mortally wounded."

Another issue is how BMW will fare if the U.S. economy tanks. One wild card is leasing, which accounts for one-third of the vehicles BMW sells every year in the U.S. Recession-ravaged drivers could dump those cars when the leases expire, instead of signing up for new Bimmers. Yet according to Tom Purves, chairman and CEO of BMW in the U.S., luxury car owners are loathe to part with their vehicles, even in hard times. Purves also says BMW ownership has spread across all segments of affluent America: "With the trouble on Wall Street, we'd have a reduction in sales, but its percentage isn't so great as to make a big blip."

rage in Europe. Analysts expect BMW's profits to jump as much as 50% in 2001 over last year's \$940 million, a figure which included losses at Rover.

Milberg, who got his start as an apprentice machine fitter, seems an unlikely choice to steer BMW through this makeover. After nine years at Gildemeister, a manufacturer of industrial machinery, he accepted a teaching post at prestigious Munich Technical University in 1981. Then BMW recruited him in 1993 to serve as board member in charge of production.

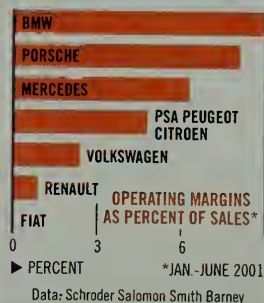
UDDENLY CEO. Milberg appeared just as stunned as everyone else when he was named CEO during a tense board meeting on Feb. 5, 1999. BMW's owners, the secretive Quandt clan, had run out of patience with Rover. Pischetrieder resigned. Then his talented No. 2, Wolfgang Reitzle, walked out after being passed over for the top job. The Quandts handed Milberg the big prize.

Milberg displayed a steely determination in opting to pull the plug on Rover on Mar. 16, 2000. "We did everything we could to turn Rover around,"

he says. The move sparked an outcry in Britain, where thousands of jobs were at stake. But the Bavarians heaved a sigh of relief. "The feeling was, now we can get moving again," says Chief Financial Officer Helmut Panke.

But other problems lurk at BMW. The carmaker suffered an exodus of managerial talent in the final throes of the Rover saga. It takes years to develop a new car, so it's too early to assess the impact of such losses. Yet concerns over the depth of BMW's bench have already surfaced. Take BMW's 7 series sedan, which hits U.S. showrooms in January. Critics rave about the engineering, but complain that the designers' quest to give the sedan greater presence resulted in a ponderous car. Meanwhile, a car buff wrote in to one of the auto magazines that the X Coupe concept car BMW un-

BMW'S MARGINS ARE THE ENVY OF THE INDUSTRY



Most investors are willing to back Milberg's strategy. BMW's shares are up 7% since September 11, while the European car sector as a whole is up 2.2%. "It's the stock we prefer—even more so now that we're going into a big slowdown," says Guillaume Rambourg, a fund manager at Gartmore Investment Management in London.

What comforts Rambourg is the loyalty BMW owners show to the

brand. More than two-thirds are repeat buyers, which allows the company to price its cars 10% to 30% higher than comparable models, says Karl-Heinz Kalbfell, BMW's brand-management director. That's a powerful advantage, considering how savagely mass-market carmakers are discounting. And BMW will need every one of its strengths to ride out this recession in comfort.

By Christine Tierney in Munich, with Joann Muller in Detroit

COMMENTARY

By Carol Matlack

THE HIGH COST OF FRANCE'S AVERSION TO LAYOFFS

It was a sad ending for appliance maker Moulinex, once considered an icon of French industry. On Oct. 22, a bankruptcy court approved the sale of most Moulinex assets and brands to French rival SEB. Nearly two-thirds of Moulinex' 8,800 employees will lose their jobs as a result.

France's Socialist government reacted with predictable dismay, promising to help workers find new jobs. But government officials—not just the Socialists but their conservative predecessors—bear blame for the company's demise. As Moulinex slid deeper into the red over the past decade, authorities repeatedly blocked management's efforts to cut costs. In August, the government rejected a plan to shutter a refrigerator factory and lay off 670 workers. Instead, the company was ordered to resume talks with unions. By then it was too late. Moulinex

**Moulinex,
now bankrupt,
was blocked**

**by the government from restructuring. Why?
Its cost-cutting plans included pink slips**

sent a letter to Prime Minister Lionel Jospin's government, warning that layoff policies were hurting French competitiveness. "This trap must be loosened," they wrote.

French executives have reason to worry. Germany, where governments traditionally have been as layoff-averse as in France, is looking a lot more open-minded these days. Companies ranging from electronics giant Siemens to chipmaker Infineon Technologies to Commerzbank have announced thousands of job cuts, with

ment, and marketing. Apart from bankruptcy cases like Moulinex, virtually no companies have announced big layoffs in France this year. "We are still a civilized company," said a France Télécom spokesman recently, denying rumors that the phone operator was planning to eliminate jobs.

HANDCUFFED. An analysis by the Organization for Economic Cooperation and Development shows that Germany's anti-layoff laws are just as tough as France's. But French executives know even modest job cuts will ignite a political firestorm. Consider what happened to Groupe Danone CEO Franck Riboud last spring when he moved to close two factories employing 570 people. Riboud offered every worker a job at another factory or an attractive severance package. No matter. Protesters marched through Paris calling for a boycott of the foodmaker, and the government introduced legislation, now pending, to fatten mandatory severance pay. With unemployment creeping back up to 9%, and national elections

due next year, the pressure to protect jobs will only intensify. Already the government is pushing state-controlled Air France, which is reeling from a steep drop in traffic, to hire workers laid off by a bankrupt regional carrier, AOM-Air Liberté. "We must use every tool at our disposal," says Communist Transport Minister Jean-Claude Gaysot.

France Inc. may be ready to fight back. The Oct. 23 letter was signed by top bosses like Thierry Desmarest of TotalFinaElf and Jean-Martin Folz of Peugeot. Ultimately, they warn, workers will suffer if companies cannot restructure quickly enough to save themselves. But don't take the CEOs' word on that. Just ask the ex-employees of Moulinex.

Matlack covers labor issues from Paris.



ANTI-LAYOFF DEMONSTRATIONS PRECEDED THE BANKRUPTCY

had racked up \$120 million in losses last year on sales of \$1.1 billion. Bankruptcy beckoned.

The Moulinex saga underscores a growing worry in corporate France. To stay competitive, companies need flexibility to trim their payrolls, especially now that Europe faces its steepest downturn in nearly a decade. But laying off workers in France is nightmarishly difficult. Labor laws require lengthy negotiations with unions over planned job reductions, and expensive severance packages for laid-off workers. On Oct. 23, 56 leading French chief executives

only muted government response. Such flexibility could help German companies recover more quickly when the economy improves, says Antonella Mei-Pochtler, a senior vice-president at Boston Consulting Group in Munich.

In France, it's another story. When consulting firm Bain & Co. recently polled chief executives of 125 leading French and German companies on their plans to weather the downturn, the German CEOs listed trimming payrolls as a top priority. But French bosses put layoffs well down their list, saying they would first cut back on purchasing, invest-

Growth opportunities reside in every nook and cranny of this economy. Be the tweezers.



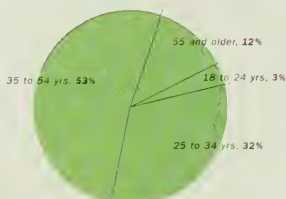
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Gartner|**G2**

The Internet market you're overlooking: go for the gray

By David Schehr

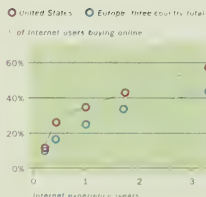
Online buyers by age



Online retail spending in Q1 2001: \$7 billion

Base: U.S. adult internet buyers (71 million)
Source: GartnerG2 and U.S. Department of Commerce

Online buying, by length of Internet experience



Base: Adult internet users, U.S., France, Germany, U.K.
Source: GartnerG2

Viewpoint

- Most online marketing is focused on the Net Generation—young adults under 35.
- Older consumers spend more online. As Willie Sutton said when asked why he robbed banks: "That's where the money is."

Dynamics

- Average Q1 2001 online spend for seniors was \$92; for Gen Y, \$40.
- U.S. consumers over 35 accounted for nearly two-thirds of all online buying in Q1 2001. One reason: There are more of them.
- Older consumers are harder to please, online and off.

Predictions

- Buy/browse ratios are near saturation, so growth rates of new U.S. online buyers will stay in the low single digits.
- Online buying in the United States will top out at between 60% and 65% of the online population over the next five years.
- In Europe, buying levels will be lower. Fewer than half of all Europeans with three years' internet experience will buy online.

Recommendations

- Attract new users to your site early, so when they are ready to buy, they buy from you. Make the browse enticing; the buy will follow.
- Target older U.S. consumers, especially the "young old" (55 to 69). Pay special attention to customer service. They certainly do.

Dig Deeper

- Related Research from GartnerG2
- Gartner Core Research
- Other Sources
- Methodology

David Schehr, GartnerG2 Research Director, has over 20 years' experience in consumer behavior and marketing research across a variety of industries—including financial services and consumer packaged goods. For the past five years, David has focused on market opportunity and strategy.



For full report: www.bethetweezers.com
or visit: www.gartnerG2.com

IS THIS MAN EGYPT'S HEIR APPARENT?

Businessman Gamal Mubarak, the President's second son, is a fast-rising star

In a beaux arts villa in the Cairo district of Dokki, groups of young men and women bend over computers or practice English language drills with Berlitz instructors. The program, called Basic Business Skills Acquisition, aims to make up for the shortcomings of Egypt's universities, which are out of date and swamped by huge numbers of students. "We are trying to provide university graduates with the basic training to get a job and be positive about themselves," says Gamal Mubarak, 37, chairman of the Future Generation Foundation, which sponsors the program.

Mubarak, the second son of President Hosni Mubarak, is a new kind of Egyptian leader. Unlike his father, a former force commander, he has opted for a

Mubarak has backed increased foreign investment for Egypt, crucial changes in the foreign exchange rate regime, and a two-year-old effort to open up the information technology and telecommunications industries. Local executives give him some credit for Egypt's thriving mobile phone sector and for the recent fast growth of its small but promising Web service and software industries.

All of the reforms that

Mubarak backs are aimed at boosting economic growth, creating jobs, and keeping Egyptians from joining radical groups, mainly by giving them a stake in society. But the Egyptian economy, which expanded rapidly in the mid-1990s, has slowed dangerously in recent years. With Egypt likely to take a further hit from the September 11 terror attacks in the U.S., Mubarak and other reform-minded Egyptians find themselves in a race against time. If unemployment, now 20%, continues to rise, and if many of the 600,000 people coming into the workforce each year are unable to find jobs, there is a risk of a social explosion. "All the people ask how this government can be stable," says Esam El Arian, a leading member of the outlawed Muslim Brotherhood, an Islamic opposition group.

Although Egypt desperately needs change, reformers like Gamal Mubarak face an uphill battle. Power in Egypt is mostly in the hands of men in their 60s and 70s who made their careers under the Arab socialism of Gamal Abdel Nasser. Gamal's father, President Mubarak, and his close aides are extremely conservative. For example, over the past three years the government wreaked havoc on the economy by trying to preserve an overvalued exchange rate. The central bank spent about \$7 billion, a third of Egypt's hard currency reserves, defending the Egyptian pound. Interest rates rose

SUBTLE Despite his insider position, in public Mubarak is careful to work through institutions

business career. After receiving his bachelor's degree and MBA from American University in Cairo, he worked for Bank of America in both Cairo and London before setting up a private equity firm called MedInvest. In the past few years, he has been raising his profile in Egypt and is often talked about as a future President, although he denies having such ambitions.

RACE AGAINST TIME.

What is certain is that through activities such as his foundation, which also runs a course for executives with Harvard Business School, he has become a politically adroit advocate of long-overdue reforms.



MUBARAK: He backs privatization and currency reforms

to the teens; the money supply sharply contracted.

The squeeze on dollars needed to finance imports became so bad last summer that businesspeople desperate for greenbacks sent aides scurrying to black market money-changers with briefcases full of cash. Executives also took their complaints to Gamal Mubarak. That eventually produced results. In intense meetings in early August, Mubarak helped persuade Prime Minister Atef Ebeid and Economics Minister Youssef Boutros Ghali to agree to a devaluation and a controlled float of the currency. As a result, the hard currency squeeze has eased, and interest rates have come down.

"STEP FORWARD." Such episodes convince many Egyptians that Gamal has his father's ear on economic matters—though the older Mubarak doesn't follow all his son's advice. In public, Gamal is careful to work through institutions such as his foundation and the Egyptian Center for Economic Studies (ECES), an economic think tank with a free-market tilt. The ECES has barraged the government with studies on everything from privatizing utilities to floating the exchange rate. "He uses these organizations as a platform," says Taher S. Helmy, a partner in Helmy & Hamza, a Cairo law firm associated with Chicago's Baker & McKenzie. "When he talks, people listen."

As in any Arab country, rumors circulate in Cairo that the President and his



CAIRO PROTEST: As joblessness soars, so does extremism

Longtime associates of Mubarak say he is careful not to abuse his status as the President's son. To avoid the appearance of conflict of interest,

for example, he didn't raise the money for his private equity fund himself. Instead, he left that job to Cairo investment bank EFG-Hermes, which manages the fund and crunches the numbers on possible investments. Mubarak sits on the investment committee of the fund, which is now worth about \$100 million—roughly twice its value when it started in 1997. Investors consider that a reasonably good performance, especially since the

HOW THE CONFLICT IS HITTING EGYPT'S ECONOMY

PRIVATIZATION Plans to privatize telecom, electricity, aviation, and parts of the oil industry are likely to be further delayed.

TOURISM Egypt's leading hard-currency earner could be set back by 50%.

PRIVATE SECTOR Private industry, which has been in recession for four years, will continue to contract.

UNEMPLOYMENT Joblessness, estimated at close to 20%, may rise, increasing social tensions.

Data: BusinessWeek

capital markets open up," he says

But these days, Mubarak says he devotes half of his time to business, with the rest spent on public service. He operates out of spacious but modestly decorated offices high in an ugly concrete building in the north Cairo neighborhood Heliopolis. Plainclothes security men stand guard in the dust-caked street outside. Apart from his economic ideas Mubarak has been trying to remake his father's political party—the National Democratic Party—for what he says will be a more open political era. However Egypt still has a long way to go toward being a real democracy. Last year's parliamentary elections were marred by strongarm tactics, and the opposition won only 27 out of 415 seats. Mubarak calls the elections "a big step forward" but adds: "Have we reached our ultimate goal? Obviously not."

Mubarak's high profile, combined with his 73-year-old father's refusal to designate a successor, has led to speculation that the younger man might be in line for the top job or another high office. Brushing off such talk, he says he isn't interested in a Cabinet position and can be more effective outside the government. But what he terms "rumors" continue to buzz. "The best thing that could happen would be for him to play a more significant role in this country," says lawyer Helmy. In truth, where Gamal Mubarak ends up will depend on how the latter days of his father's rule play out and whether his reforms work. The economy looks gloomy now, but Mubarak is building a following among ambitious young people. Maybe someday their views will count.

By Stanley Reed, with Susan Postlewaite, in Cairo

ACCESS A successful push for devaluation shows that the younger Mubarak has the President's ear on economic matters

family may benefit personally from government business. A Cairo financier says when Mubarak was at Bank of America in the 1980s, he likely won government approvals faster than competitors for a lucrative program of swapping Egyptian trade debt for equity in companies or export goods. Still, "it was a fairly level playing field," the financier says.

Cairo stock market has fallen 70% since its peak in February, 1997. The fund has put its money into high-tech Egyptian companies such as Misrfone Telecommunications Co., an unlisted subsidiary of Vodafone that is planning to go public. Mubarak is now interested in widening the fund's activity to surrounding countries. "There is a lot of hidden value as

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AGAINST THE FLOW AT DUKE ENERGY

CEO Priory is making an integrated utility pay off big



On September 11, Richard B. Priory, chief executive at Duke Energy Corp., had just started a staff meeting to discuss a bid for Westcoast Energy Inc.—a deal he had sought for more than three years—when a secretary slipped him a note: A plane had crashed into the World Trade Center. Priory ducked outside to get details of the attack and to order stepped-up security at Duke's nuclear

plants. Then, he and his managers quickly voted to proceed with the bid for the Vancouver gas-pipeline company.

During the next week, Priory worried about making an \$8.5 billion bid amid so much uncertainty. But on Sept. 20, he announced the deal, the first major merger after the terrorist attacks. "Even if the timing might not seem right to others, Rick's not afraid to go for it," says Fred J. Fowler, group pres-

ident for Duke's energy-transmission business. Or as Priory puts it: "We didn't want to wait another month or two and lose the deal."

The decision was vintage Priory. In his four years at the helm of Duke, in Charlotte, N.C., the 55-year-old New Jersey native has made many high-stakes bets in fields that other energy executives shied away from. Priory has aggressively moved Duke beyond its beginnings as a regulated electric utility serving the Carolinas. He got the company into the largely unregulated business of producing and reselling energy to smaller utilities throughout the country. And he was among the first to buy into natural gas.

"A CASH-FLOW MACHINE." Since then, Duke has become one of the most integrated energy players around: It controls everything from gas reserves to pipelines to power plants. And it has massive, but conservative, trading operations that have supported it all. Owning pipelines gives the \$66 billion company the flexibility to exploit the ups and downs of the energy chain. Gas prices up? Sell more to customers. Gas prices down? Burn it for electricity. "He took a company with a regional franchise and made it into arguably the biggest and best of the integrated energy companies," says Kit Konolige, an analyst at Morgan Stanley Dean Witter & Co.

While rivals such as AES Corp. and Exelon Corp. have watched their fortunes fall along with energy prices, Duke announced on Oct. 16 that its third-quarter income rose 46%, to \$796 million—or one-third more than Wall Street was expecting. For the year, profits should be \$2.08 billion, on revenues of \$65 billion. Earnings per share could increase by about 30%, outpacing the industry, which should average 15%.

While few energy companies have seen their stock rise this year, Duke's has held up better than most: It is down 11%, compared with an average industry drop of 24%. And after closing the Westcoast deal, Duke

HYBRID In natural gas, pipelines, and power plants— Duke is there

will have access to critical Canadian reserves to feed through its new gas-fired plants—many of which will be built out West. "They can turn Westcoast into a cash-flow machine," says Banc of America Securities analyst Daniel L. Tulis.

Indeed, this is a pretty good time to be a hybrid energy company. Since there is little financing available through Wall Street, companies like Duke and Dynegy Inc. can still expand by spending the

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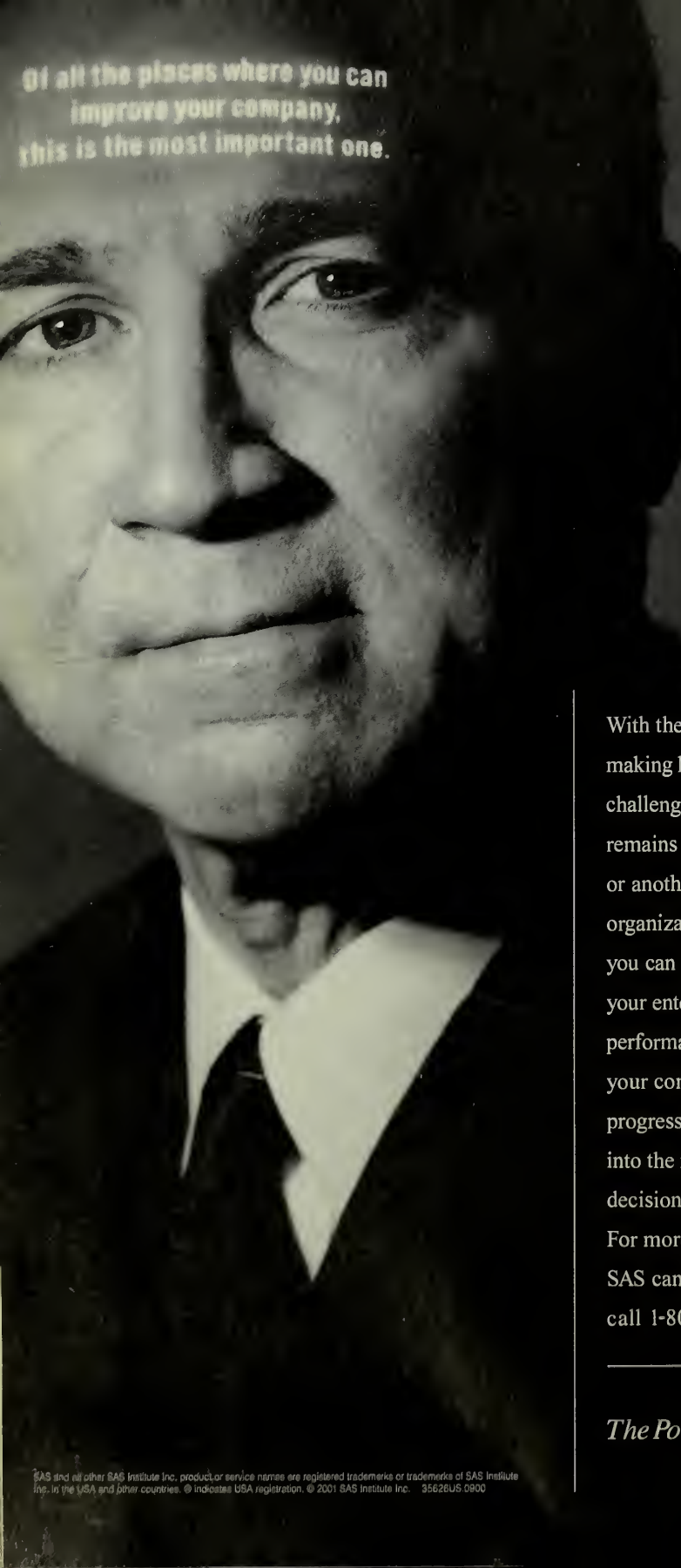
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People

Priory has moved into the largely unregulated business of producing and reselling energy to smaller utilities throughout the country

ush their regulated businesses generate. At this point, 30% of Duke's revenues come from such operations. Enron Corp., by contrast, has agreed to sell its regulated business, which would leave it without such a reliable source of funds.

If Priory isn't your typical utility executive, that may be because he was sucked into the business. Priory's passion was baseball: In high school, he was on a tryout with the New York Mets, but was missing a slot on the farm team. While his classmates headed off to college, Priory worked as a carpenter and bricklayer. After a few years of knocking ice off his tools in the dead of winter, however, Priory reconsidered. He decided to study engineering, first at West Virginia University and then at Princeton University.

After teaching engineering at the University of North Carolina at Charlotte and consulting on the side, Priory in 1976 accepted an engineering job at one of his clients: Duke. In no time, he developed a reputation as an up-and-comer: "Most of Duke's engineers were still using slide rules, and in comes Rick knowing how to write computer code in Fortran," recalls Vince Sorrentino, a retired engineer at the company. Priory helped design several of Duke's nuclear plants, and by 1984 he was in charge of design engineering. By the mid-'90s, he was heir

apparent to then-CEO William H. Grigg. **REGULAR GUYS.** When Priory took over the company, he knew two things for sure: Deregulation was coming, and Duke wasn't ready. For starters, he says, employees had a civil-service mentality. "If you lived long enough, you got promoted," he says. To build a more entrepreneurial culture, Priory eased out many senior managers, replacing them with executives who had lived through deregulation in banking and telecommunications.

Priory is still very much the engineer. He's deeply analytical and usually seeks a consensus among his managers.

And his head isn't turned by the perks of the job. He traded a penthouse office for a modest space on the third floor of Duke's 13-story building, saying only that it saves him five minutes travel time. Friends say that Priory doesn't usually golf with other CEOs or Duke executives. "Rick is more comfortable hanging out with regular guys," says Peter Loper, a Charlotte physician.

Priory has swung more than 80 deals, most of them contrarian, and most successful. His 1996 bid for PanEnergy

RICHARD PRIORY

BORN May 15, 1946, Lakehurst, N.J., son of a Navy blimp pilot and a sewing-machine store manager

EDUCATION BS, civil engineering, West Virginia Institute of Technology; MS, engineering, Princeton University

POSITION CEO, Duke Energy Corp., since 1997

FIRST JOB After his parents separated, he sold men's suits after school to help his mother make ends meet

OTHER CAREER OPTIONS Won a tryout in the mid-1960s with the New York Mets—but lost the last farm-system slot to Ron Swoboda

AFTER HOURS Used to play competitive softball; now an avid golfer, his biggest thrill was playing with idol Arnold Palmer

FAMILY Married to Joan; they have a grown son and daughter

Corp. was one of the first deals between an electric utility and a natural-gas supplier. He bought into South America in 1999, when other U.S. companies were bailing out, scooped up a liquid-gas business two years ago that no one else would touch, and sold a Texas plant he had just built because he figured new projects from rivals would create a supply glut. "I'm always more concerned about the companies on the other end of a deal with Duke," says Tulis. So far, Priory has done well for himself by zigging when others zag.

By Dean Foust in Charlotte, N.C., with Christopher Palmeri in Los Angeles

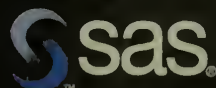


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THE RESOURCE FOR ENTREPRENEURS NOVEMBER 5, 2001

CAPTAIN OF INDUSTRY

Michael Beirne, CEO
of Novaforge Inc.
in Arlington, Va.,
has been called up
to serve as an officer
in the homeland
defense force

THE AFTERMATH

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AND WHAT THEY'RE DOING ABOUT IT

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BusinessWeek

Small Biz

SMALL BIZ
ONLINE

A Mild Slump?

Entrepreneurs are bracing for recession, but if history is any guide, it may be milder than expected. Data from 1950 to 1998 show that income at small businesses fell in only eight quarters, vs. more than 50 for corporate income. What's more, the small-biz slumps were shorter and less steep. The reason: more flexibility.

What to Cut

What's the best tax cut to inspire startups? Kill the alternative minimum tax, says the National Council on Entrepreneurship. That would work faster than a capital gains cut.

Rates Plunge

Rates on small commercial loans fell below 8% in the third quarter. The Federal Reserve says rates averaged 7.73% on loans up to \$100,000 and 6.89% on loans up to \$1 million.

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PAGE 16: The attack forces owners to rethink their business

IN BOX

4 Backup procedures are no longer optional. Plus: How to communicate with rattled employees, the outlook for bank loans, and membership freebies

FRONT LINE

7 Survival Skills
Thousands of businesses around Ground Zero are struggling to recover from the September 11 disaster. A lot of them won't make it

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The top executive MBA schools for entrepreneurs

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Can't face the idea of travel? Web conferencing could take up the slack

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Warming up, reluctantly, to the art of cold calls

UNDER 30

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11/5/2001

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Cover Story

The Aftermath

You didn't have to be New York-based to feel the shock waves from September 11. Small companies nationwide are trying to cope. Some must make drastic changes because their business model is wrecked. Others just have to batten the hatches and try to ride out the storm. And some are discovering to their surprise that demand for their product is booming. How to tell which category you're in, and what you can do about it

PAGE 4
Where to find a safe place for crucial backup data



Cover photograph by Katherine Lambert, Large photograph above by Pej Behdarvand

iNBOX

EDITED BY NAWEEN A. MANGI

Back Me Up Here

DATA RECOVERY IS FRONT AND CENTER AGAIN

AMONG THE HARD LESSONS of September 11: the importance of data backup. Ask Irshad Ahmed. As president of seven-employee Pure Energy Corp. on the 53rd floor of the World Trade Center's north tower, he planned a "doomsday scenario" after the 1993 bombing. Yet, on September 11, **AHMED LOST 35% OF HIS RECORDS.** To work, backup must be done routinely. Subscribe to an online storage service, such as Xdrive Technologies Inc. (\$99 a month for 1.88 gigabytes) or Oracle Corp. (\$99 a month for five users). **TAPE AND DISK MEDIA CAN BE MOVED OFF-SITE.** Leading vendors include StorageTek and Hewlett-Packard Co. (about \$20 to \$80 per gigabyte). Or sign up for the kind of disaster and recovery services offered by SunGard Data Systems Inc. of Wayne, Pa., or CAPS Inc. in Shelton, Conn., which provide data backup and emergency work space.

SO THEY SAY

"My business was my baby. There's a part of me that is... grieving."

—JANINA FARINAS, owner of Planit Right Inc., a meeting organizer that has seen business plummet after the September 11 attack (page SB16)

ONE IOTA

BE PREPARED:

Percentage of fast-growth CEOs who say risk management is important in the next 12 to 24 months

Data: PricewaterhouseCoopers

81

Making It Worth Your While

Trade and business groups, hurt by the slowing economy, are luring new members with an array of products and discounts. Samples: the American Society of Association Executives offers 36% off video-conferencing services; the NFIB is selling low-cost term life insurance. Maybe lone wolves will now want to join the pack.



Venture Forth

WHERE VCS ARE SPENDING NOW

IF YOU'RE HUNTING for venture capital, don't give up. True, vcs polled by the National Venture Capital Association after September 11 expect "extremely difficult" economic conditions over the next 12 to 18 months. And true, they're getting stuck with portfolio companies for longer than planned as M&A activity slows and the **IPO MARKET DRIES UP**. "But that doesn't mean there's a shutting off for new deals," says Craig A. T. Jones, president of Ticonderoga Capital Inc. in Wellesley, Mass.

Indeed, after spending the past 18 months nursing portfolio companies, vcs now have \$45 billion for new investments, and **THEY'RE SCOUTING AROUND** for promising early-stage companies. They'll just be "looking at things more thoughtfully," says Jennifer Jones, marketing partner at Mayfield, a vc firm in Menlo Park, Calif. vcs say much of the money will be directed to security and communications software as well as defense-related technology. So it goes in the post-September 11 world.

Will Jittery Lenders Dial Back Credit?

Shock waves from the September 11 attacks have shaken the confidence of small-business lenders. A third-quarter survey taken in late September by Phoenix Management Services Inc. found 42% of bankers saying the terrorism made them less likely to lend to small companies. Only 26% expressed similar wariness about large corporations. "In an economy that's already shaky, this added negative event will have a much greater impact on small companies, which tend to be less capitalized," says Michael E. Jacoby, executive vice-president at Phoenix. Indeed, 69% of bankers expect lending to small companies to decline over the next six months, up from 55% last quarter.

Hitting the Wall

WHAT MAKES SMALL-BUSINESS OWNERS RELUCTANT TO SPEND ON NEW TECHNOLOGY?

17%

lack employees with necessary info-tech skills

14%

say just running the business leaves little time for IT upgrades

13%

don't know how to apply technology effectively to their own company

8%

can't justify the expense with a clear return on investment

Data: Comdex Research Panel Small-Business Study



SOUND BITES
Marlene Pagley-Waldock, communications consultant, on communicating with WORKERS IN STRESSFUL TIMES

What sorts of management challenges are entrepreneurs facing? The biggest challenge is simply getting people to focus again. There is still an inability to do the things employees did before because of the anxiety and depression.

What mistakes can you make right now in communicating with employees? In their fervor to get things back to normal, entrepreneurs may push too hard. They may not be as sensitive as they need to be in their verbal or written communication. They shouldn't overlook that this can be a very good time for team-building because there is a lot of spirit now that can be moved into the business.

How do you balance being sensitive with achieving results? Communicate often and set goals for employees. But keep communications short and focused on one short-term goal. People can't think out into next year now. You need to be firm but light-handed.



\$45 BILLION VC KITTY: Craig Jones and Jennifer Jones are scouting—just more carefully



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LINE

NEWS
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STATS OF THE MONTH

87%

of fast-growth CEOs say growth hinges on good customer service

89%

of SBA award winners use their Web site as a marketing tool

66%

of small-business owners say cash flow is a problem



IN LIMBO
Rachel Allgood's
office and home
are off-limits

MANAGING

Fighting for Survival

LOWER MANHATTAN'S SMALL-BIZ NIGHTMARE **BY LARRY KANTER**

FOR NEW YORK GRAPHIC DESIGNER Rachel Allgood, the nightmare of September 11 refuses to end. It's with her every day: in her lungs, which were injured from inhaling chemicals and glass, and in scratches on her calves and feet.

Her Tribeca flat remains off-limits, as does her Greenwich Street studio, which once housed her seven-person design shop, Isocurve Inc.

The 34-year-old entrepreneur has since returned to her studio, escorted by federal mar-

shals. Everything was covered in a thick layer of dust. She grabbed some files and a few computers, and installed them in a temporary office in Greenwich Village, where she struggles to get Isocurve back on track. Revenues hit \$1 million last year, but the focus now is less on sales than on survival. With no income coming in, she has tapped a personal savings account, and is fighting her insurance company, which she says won't pay up. Meanwhile, she's digging through what's left of her records, searching, often in vain, for the documents she needs to apply for a disaster relief loan. "Rebuilding my life," Allgood says, "is a full-time job."

DIGGING OUT

THE ECONOMIC TOLL exacted on New York City by last month's attacks is by now well known: 13 million square feet of office space destroyed; \$34 billion in property damage; \$1 billion in lost city revenues. Buried in those statistics are the stories of thousands of entrepreneurs like Rachel Allgood. Despite its reputation as a corporate hub, Lower Manhattan is very much a small-business center, with perhaps the densest concentration in the nation. At least 25,000 small businesses make their home on the southern tip of the island below Houston Street—more than the total in cities like Toledo, Ohio, or Baton Rouge, La., according to Dun &

hit, Zimmerman says, "the ceiling started coming down. Our only thought was to get out." Computers, files, briefcases, and Palm Pilots were left behind. Zimmerman even neglected to slip her pumps back on. She exited the building and found herself in stocking feet, tiptoeing across shards of plaster and shattered glass.

It's as though she has been walking on broken glass ever since. The firm is homeless, camped in a conference room on loan from a friend. For two weeks, they had neither phones nor e-mail, making it all but impossible to reach clients. What's worse, those clients are in the finance industry, and have postponed or canceled hiring plans. "Our revenues are going to be devastated," she says.

Banks and the U.S. Small Business Administration have stepped up with low-interest loans. But as of Oct. 19, only 2,159 businesses had applied for loans, and only about 447 loans, for a total of \$47.9 million, had been approved. The slack demand makes

sense to Zimmerman: "This seems like a bad time to be taking on debt." Indeed, many fear that a wide swath of small businesses will simply fold beneath the pressure. "They can't pay bills; they can't pay rent," says Madelyn Wils, chairwoman of Community Board 1 in Lower Manhattan. "I don't know how many will make it."

PULLING UP STAKES

THAT POSES A SERIOUS challenge for the city, which lured thousands of small

GROUND ZERO

In the aftermath of the September 11 attacks, Dun & Bradstreet surveyed the condition of lower Manhattan's businesses



businesses downtown in the mid-1990s. City officials have created a bridge-loan program for entrepreneurs awaiting their SBA funding, and are set to launch a grant program. But with much of the financial district still in ruins, "there's a limited amount of resources we can bring to bear," says Michael Carey, president of the New York City Economic Development Corp. "Downtown will rebuild. But people need to be patient."

The signs aren't good: Even relatively healthy companies are wavering. Pisarkiewicz Masur & Co., a 10-person marketing company based four blocks east of the Trade Center site, has emerged more or less unscathed. Several key deals have been postponed, and the company dismissed two employees. But new clients are coming in, and sales are expected to reach about \$2 million in 2001. When its lease expires in February, though, the company is considering moving to New Jersey, where most of the executives live. "It's just so sad here, like a big graveyard," says Mary F. Pisarkiewicz, the company's president. In such an atmosphere, digging out will likely continue long after the cleanup crews have gone home.

@SB For more stories about New York City's entrepreneurs, click Online Extras at smallbiz.businessweek.com

"The ceiling started coming down. Our only thought was to get out"

Bradstreet Corp. Citywide, small companies account for about 85% of all jobs, says Marc M. Goloven, an economist at J.P. Morgan Chase & Co. Financial services, by contrast, employs just 5%. "These small businesses are the city's fabric," Goloven says.

How badly is that fabric frayed? Ask Joan Zimmerman, executive vice-president at G. Z. Stephens Inc., a five-person executive search firm that was based on the 47th floor of the World Trade Center. When the first jetliner

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ALVAREZ (LEFT)
AND HICKS:
Rave reviews
for the exec
MBA program
at SMU



EDUCATION

Class Distinction

THE TOP EXECUTIVE MBA PROGRAMS FOR SMALL BIZ

AT SOUTHERN Methodist University's Cox School of Business in Dallas, entrepreneurship is a required course for every executive MBA student. But no one's complaining—Professor Jerry F. White's entrepreneurship class is wildly popular. Senior execs and entrepreneurs in this rigorous 21-month, part-time degree program apply everything they've learned to plan a new venture. It's easy to pick out the business owners. Says White: "Their questions are more urgent."

Cox places No. 19 in *BusinessWeek's* 2001 overall rankings of the best Executive MBA programs in the U.S. and abroad. But in entrepreneurship, SMU soars to the top of the class. Students praise White's use of Dallas business leaders and venture capitalists as lecturers. In fact, Steve Hicks, 36, co-founder of Custom Factory, a nine-person Dallas software company, says he joined the program—and is footing the bill of \$56,000 himself—based on rave reviews from one of his partners, Michael Alvarez, a 1998 Cox graduate.

In its first ranking of EMBA programs in a decade, *BusinessWeek* surveyed recent grads of 82 business schools and polled EMBA program directors. *BW* received 3,041 responses, for a 60% response rate. In addition, the EMBA grads were asked to rank their school on a scale of 1 to

5 in entrepreneurship. The best are listed below.

The winners, with tuition ranging from \$42,000 at the University of Pittsburgh to \$66,600 at Georgetown, all offer a strong hands-on component. No. 2-ranked Georgetown University (No. 9 overall) assigns execs to work on a consulting project for a small company in Latin America. At No. 3 University of Pittsburgh (No. 31 overall) EMBA director Kathryn Grabowski says entrepreneurial training is used to help spearhead local economic development. And No. 4 London Business School (No. 23 overall) runs its own VC fund to finance promising student ventures. "We're prepared to invest in our own product," says professor John Bates.

Among the elite, No. 5 UCLA (No. 10 overall) has the greatest share of students from small businesses—35%. This concentration gives classes the feel of a consulting session, with everyone sharing expertise, says 2001 grad Vipul Goel, CEO of NetAppl Inc., a Bay Area into-tech software vendor. The 25 hours of weekly homework paid off, too: He has used what he learned to boost his bottom line by 25%. Not a bad return in anyone's book.

—BRIAN HINDO

@SB For a more complete ranking of entrepreneurial EMBA programs, go to Online Extras at smallbiz.businessweek.com

Best for Entrepreneurs

Graduates ranked these B-schools as the top five for entrepreneurship programs.

School	Tuition	% students from small biz	Comments
Southern Methodist (Cox)	\$55,825	15%	Professor Jerry White's popular entrepreneurship class is required for all EMBA students
Georgetown (McDonough)	\$66,600	16%	Students consult to small companies in Latin America during a weeklong residency
Univ. of Pittsburgh (Katz)	\$42,000	7%	Plans to provide alums with networking and faculty resources for startups
London Business School	\$54,000	19%	Offers five electives, including law, finance, and venture capital
UCLA (Anderson)	\$60,370	35%	Wide range of entrepreneurship classes offered as electives

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A photograph showing three silhouetted figures performing handstands on a sandy beach at dusk or dawn. The background shows a calm sea and a cloudy sky.

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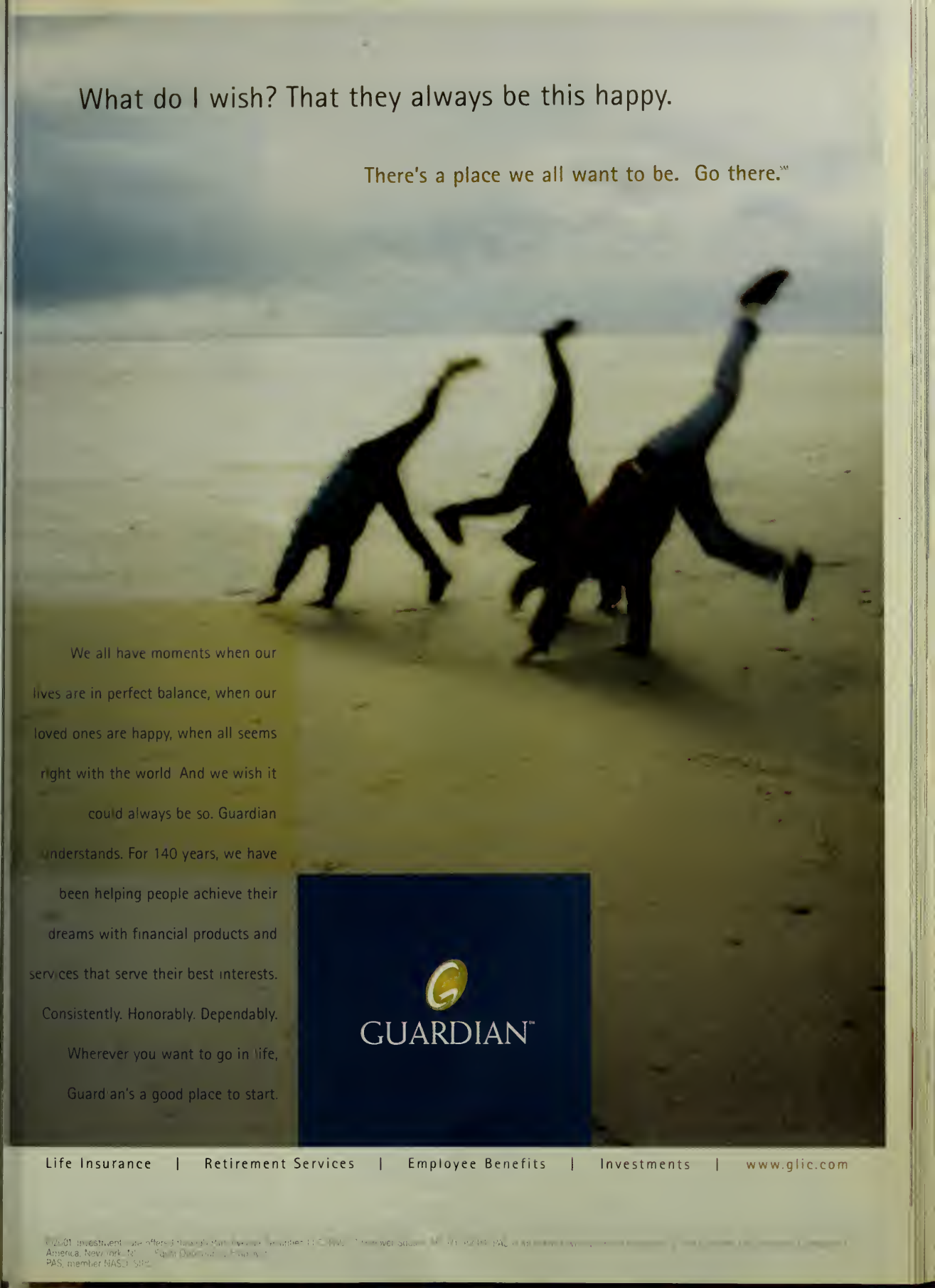
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Fear of Flying

WEB CONFERENCING: THE NEW ALTERNATIVE

LEERY OF HOPPING on a plane for meetings? Web conferencing may let you hop online instead. Blending audio, video, and document-sharing technology, Web conferencing creates virtual meeting rooms where people "gather" at a password-protected Web site. There, they can chat in conference calls or use real-time text messages. They can mark up a shared document as if it were a blackboard and even watch live software demos or video clips.

For those trying to cut costs, the price is attractive: about \$100 per month per user. "Travel got to be quite expensive," says Robert W. Bean, CEO of Marlborough (Mass.) software developer CADKEY Corp. Now, in a virtual meeting room hosted by WebEx Communications Inc. in San Jose, Calif., Bean pores over the details of his new computer-aided design software with his sales manager in Caldogno, Italy; his customer in Loudon, Tenn.; and his distributor in Coventry, England. CADKEY's cost: \$10,000 a

year, plus a onetime licensing fee of \$15,000 so that its 100 dealers can also use the service. Annual savings come to \$50,000—not bad for a company with 45 employees and revenues of \$7.5 million.

James W. Weaver, CEO of Tracker Management Systems Inc., in Cleveland, says Web conferencing helps with sales, too. "I just did a remote product demo to a company in Holland," says Weaver, whose 11-person company develops emergency-dispatching software used by tow-truck operators. He thinks the system can add \$50,000 to his bottom line.

ONE PROGRAM SERVES ALL

Perhaps the biggest surprise about Web conferencing is its simplicity. You just set up an account and download a few small software files. Those attending don't need the same hardware or software. Want to share a technical drawing made with proprietary software? Some PowerPoint slides? No problem. Every participant can see

RANDOM access



AN EYE FOR SECURITY

Retina scan, move over. The latest technology using physical features for identification is more precise because it relies on the iris. The Panasonic Authenticam Iris Scan (\$289) checks a would-be computer or network user's iris against a pre-existing database, then—assuming the person is authorized—automatically allows access (www.iriantech.com).



IT'S IN THE CARDS

Need to get that pile of loose business cards into your contact manager? The CardScan 600c will read the info into most popular databases. It's smaller than prior models, registers color, and has a built-in link that takes you right from a contact's address to driving directions from MapQuest (www.cardscan.com).

what's on anyone else's screen. Want to see faces? Even the cheapest plug-in video camera will work. The quality is poor, though, so don't count on reading facial expressions or body language.

If you're interested, you can sample Web conferencing. WebEx Communications Inc. (www.webex.com) and PlaceWare (www.placeware.com), two of the more established services among dozens now available, offer free trials. But be aware you'll need a Web connection of at least 56 kilobits per second. Without broadband, some of the more dazzling features—live video feeds and shared software applications—are agonizingly slow. Still, at 56K you can run a PowerPoint presentation with real-time text chat or view the same document at the same time—and skip the small talk, too.

—KEVIN FERGUSON



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MY COMPANY

Dialing for Dollars

WHEN THE HEAT IS ON, IT'S TIME TO GO COLD-CALLING **BY KEVIN KELLY**

LAST WINTER, AS PART OF A BROADER EFFORT to increase sales, I started cold-calling prospects. "Hi, my name is Kevin Kelly," I usually start out. "I own a company called Emerald Packaging. We manufacture plastic bags. I know you buy quite a few, and I'm hoping to get a bit of your time to find out how we can help you." Usually they half-listen, interrupt with a snarl, and hang up. Occasionally I get a bite.

I hate cold-calling. In fact, I despise cold-calling. But dial I must, for ringing up strangers is part of a sweeping change in the way we approach sales. Besides, it works.

Traditionally, our family business relied on brokers and distributors for sales, and narrowly focused its product line on packaging for produce. That strategy proved effective because the brokers can provide expertise the customer desperately needs (and we lack), such as knowledge of machinery and food science. So, while the folks who make a living at it did the prospecting, we concentrated on manufacturing—and saved over \$100,000 a year on salespeople, to boot.

In recent months, however, my brother Jim and I have begun to hit the streets, especially where we're trying to push into new markets. Why? Sometimes we don't know a broker or distributor in a market, or they're already wedded to a bag supplier. Often, though, we find that to grab a new customer we have to compete on price, and there just isn't room these days for the 5% cut that a broker or distributor demands. Likewise, cost-conscious purchasing agents are looking to eliminate middlemen wherever they can.

There's another financial pressure, too. Like many entrepreneurs, we invested heavily in capital equipment in the late 1990s, spending close to \$5 million on new printing presses and bag machines. Now it's time for that technology to pay for itself. Many of the new markets we're going after, such as frozen-food packaging and newspaper bags with glossy ads on them, take

advantage of the quality our machines can deliver. Since we don't know brokers or distributors who are willing to help us out in either segment, we have to make the calls ourselves.

Certainly, we couldn't have picked a worse time to ramp up a sales campaign. Even before September 11, the slowing economy had slashed the number of companies looking to buy packaging. In the aftermath of the attacks, many potential customers seem so spooked about the future that they're content just to work down inventories. And product introductions—the vehicle many companies use to try out new packaging suppliers—have just dried up.

Still, we've had our share of successes. Last fall, I saw a frozen-food item in the grocery store that required photographic print quality—a perfect fit for our new printing press. It turned out that the prospect was a local business as well, only three miles from our factory. They expressed some interest when I called, and then we got really lucky: One of their existing print suppliers went out of business. They had a high-quality job that required a fast turnaround, and we stepped into the breach.

As happy as I am with the outcome, I view the cold calls as a short-term measure. I'm doing it because we don't have the internal resources to go after new sales any other way. And if I'm going to ask my brother, sister, and our sole internal salesperson to take on this unpleasant task, I have to lead by example and share the pain. Believe me, it wasn't for kicks that I recently listened to a purchasing agent growl that I'd be "wasting the postage" if I sent some promotional materials his way. But with the economy slowing, bills coming due, and expensive equipment in place that we can't afford to let sit idle, we really have no choice.

Kelly is an officer of Emerald Packaging Inc. in Union City, Calif. Have you tried selling, too? E-mail us at smallbiz@businessweek.com



I have to lead by example and share the pain

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How the terror attacks will affect small companies, and what they're doing about it. By Naweena A. Mangi

MEETING PLANNER JANINA FARINAS' MOST PRESSING TASK RIGHT NOW IS PLANNING FOR HER company's demise. With the travel industry in a free-fall since last month's terrorist attacks, her New Orleans-based company, Planit Right Inc., has lost \$1.5 million in expected business, leaving her no choice but to shut down. "My business was my baby," Farinas says. "There's a part of me that is very sad and grieving."

In Fairfield, Iowa, Burt Chojnowski, CEO of the Internet telephony startup CoolCall Inc., is still hoping for a round of financing that's been postponed indefinitely. The deal was scheduled to close on September 11. To conserve cash, Chojnowski has imposed a 25% pay cut and has been frantically renegotiating with vendors.

Meanwhile, in Hayward, Calif., Lynne Leahy, CEO of AquaPrix Inc., has never been more bullish. Her company, which distributes distilled-drinking-water systems, has been flooded with inquiries since the attacks, and now looks forward to a jump in 2001 revenues. "This could be bigger than anything we've done in the past," she says.

And then there's Arlington (Va.) entrepreneur Michael Beirne (cover photo), CEO of Novaforge Inc.—and a captain in the U. S. Army Reserves. He's pulled between his enthusiasm for his new company and his obligation to serve his country.

So it goes in post-September 11 America. Terrorism in New York and Washington has turned the world upside down for everyone, and small-business owners are no exception, no matter how far they are from the East Coast targets. "There isn't a small business that hasn't been affected," says Pamela Harper, a strategic consultant in Glen Rock, N.J., who has worked with entrepreneurs for 10 years. "Companies need to totally reassess the priorities they had before Sept-

ember 11. Everybody is going to find this to be a challenge.”

It's a challenge not everybody will be able to meet. Robert Calvin, professor of entrepreneurship at the University of Chicago, predicts a flood of business liquidations in the next six months. “Every time there's a disaster, small companies are pushed over the edge,” says Calvin. “They are not diversified, and so they suffer the most.”

Entrepreneurs themselves seem to be feeling a rare moment of self-doubt. After a generally upbeat reading in August, the National Federation of Independent Business' index of small-business optimism plunged to its lowest level since 1993 following the attacks. Expected sales gains over the next three months turned negative for the first time in the survey's 15-year history, and the percentage of business owners anticipating better business conditions over the next six months dropped to 10%, compared with 25% in August.

The pain is not being felt evenly. Some companies have found themselves in the somewhat awkward position of benefitting from the tragedy, as demand for security and defense-related products rises. But most small companies are simply coping, stumbling through a new world of uncertainty in which spending decisions have been postponed until next year, and the objective is simply to hold on. The less lucky ones, in such hard-hit sectors as travel, financial services, and manufacturing, are finding their old business plans irrelevant. “Small business can't escape the pain,” says Thomas Gray, president of the Center for Small Business Studies in Washington. “And in the short term, we're due for more pain.”

taking a direct hit

AFTER THE SEPTEMBER 11 ATTACKS, Janina Farinas was among those who discovered that her entire business was obsolete. When she launched Planit Right, her international meeting-planning agency, in 1999, her prospects couldn't have been brighter. American corporations were big on incentive packages, and hired Farinas to plan vacations for valued employees. She closed 2000 with \$1.2 million in revenues and expected to hit \$1.8 million in 2001.

But as airports around the country sat idle after September's attacks, Farinas watched her company disintegrate. Her biggest contract of the year, worth \$250,000, was canceled when an insurance company scotched a trip to New Orleans for 300 sales executives. Soon afterward,

seven more deals worth a combined \$1.5 million unraveled. “I took a really deep breath, shed a few tears with my staff, and sat in silence in my office,” she says.

Ultimately, Farinas pulled the plug on Planit Right. But she has a plan. She intends to apply for a \$75,000 bank loan to carry her over the next few months as she and her team reinvent the company to organize seminars on “spiritual uplift” for professionals. “After what's happened,” she says, “what's needed is a journey inward.”

Perhaps she's on to something. During the next few months, many business owners will be facing their toughest challenge ever—one fraught with personal, as well as economic, risks. “When a large company is hit, there is an infrastructure that rallies to its support,” says Marilyn Puder-York, a New York psychologist and executive coach. Small-business owners, by contrast, are forced to rebuild their businesses alone. That's scary, Puder-York says. But it also presents an opportunity. “As an entrepreneur, you have a certain degree of freedom to reinvent yourself, to save or change your business,” she says.

That's Roxanne Zavala's strategy. As CEO of Anoroc Precision Sheet Metal Inc., a Gardena (Calif.) manufacturer of aircraft components, she expected revenues to double, to \$3 million, in 2001. But in the wake of the attacks, Boeing Co. laid off 25,000 people and halted the production of new aircraft—a big problem for Zavala, who gets 75% of her business from Boeing contractors. “After investing 23 years of my life in this business, I was wondering whether we would be able to survive,” she says.

The way Zavala sees it, she has little choice but to reinvent herself. Capitalizing on her status as a certified minority contractor, she plans to start bidding on federal contracts. She's also venturing beyond the aerospace industry to make parts for electronics and medical equipment. It won't be easy. For the first time in Anoroc's 23-year history, she's taking on debt, applying for an SBA-backed loan for \$500,000 to \$1 million. And although she has staved off staff cuts so far, they're inevitable unless business picks up. “I'm very worried about my business,” Zavala says. “But I'm a survivor.”

Survival instincts will only get you so far. What entrepreneurs need is cash, and while Washington has been working on rescue packages for the airline, insurance, and shipping industries, no one has rushed to bail out small business. The SBA is offering low-interest disaster loans, and sev-

in their own words

How has life changed since September 11? Here's what a sampling of small-biz owners have to say

“I've had 10 years in the business, and I'm not going to let it crumble because of what happened. We're just determined to move on and make the most of whatever we're left with.”

MARY JO BLYTHE
MasterPlan Inc.,
a meeting specialist
in Clarendon Hills, Ill.

“This place is usually hopping, but it's a lot quieter now. We've changed the types of clients we're pursuing. This has really changed our business model.”

LEZA RAFFEL
Communications Solutions
Group, a public relations
firm in Jenkintown, Pa.

“We're getting 200 projects a day, compared to five or 10 before. This is our best year ever. But I feel bad that our business is benefiting from something so horrible.”

DAMON GERSH
Maxons Restorations,
a New York damage-
restoration company

“No matter what we do, it will be a struggle. We will lose money and I will have to borrow. I'm very, very unsure about my company, but I know we'll survive.”

MATT DELINE
SaveCash.com,
a hotel reservation service
based in San Diego, Calif.

eral banks have rolled out similar products. As of Oct. 19, the SBA had approved fewer than 500 loans, and bankers admit that those most in need of assistance may go begging. "A lot of companies had weak balance sheets before September 11," says John McWeeney, executive vice-president and regional director for small-business services at FleetBoston Financial Corp. "We're trying to offer more favorable terms. But these still have to be loans we think will be repaid."

On Oct. 3, Senator Kit Bond (R-Mo.), the ranking Republican on the Senate Small Business committee, introduced legislation to provide entrepreneurs with tax relief, emergency loans, and greater access to federal contracts. But small-business lobbies say more help is needed, and right away. "So far, I would give the government a C. It's not a D or F yet, but it will get there in a couple weeks if nothing happens," says Karen Kerrigan, chair of the Small Business Survival Committee in Washington.

caught in the downdraft

ENTREPRENEURS LIKE Mike Wilkinson are just trying to hold on. There's nothing fundamentally wrong with Paragon Innovations Inc., a Plano (Tex.) electrical-engineering company with 18 employees in an industry not directly tied to the disaster. Still, the CEO has seen more than \$1 million worth of business postponed since September 11. "Clients are saying that they're still on track, but that they've paused," the 37-year-old entrepreneur says. "It's driving me nuts." After seeing revenues grow 40% a year since starting the company in 1990, Wilkinson is bracing for no growth in 2001 and expects profits to plunge some 75%. He has frozen capital spending and travel and is chasing new deals like never before. "It's tiring and frustrating and aggravating," he says.

Burt Chojnowski, CEO of CoolCall, is just as frustrated. On Sept. 10, the 50-year-old entrepreneur's future

Security Boon: Leahy's water-filtration company is benefiting from contamination worries

looked brighter than ever. After limping through the tech downturn, slashing his payroll from 32 to 18, Chojnowski was poised to receive \$3.1 million in new funding from an international investment group. Unfortunately, the cash had been sent to a broker in the World Trade Center, who was to send it on to Chojnowski the following day. When the towers collapsed, the stock market plunged. CoolCall's investors developed a case of cold feet and put the deal on



"Given that other businesses are failing, our problems are insignificant. Yet we are caught in that ripple effect. Our fall revenues will be 50% lower than planned."

STEVEN ROTHBERG
CollegeRecruiter.com,
a Web site for students
in Minneapolis, Minn.

"I was projecting \$7.8 million in revenues this year. But now we're in a questionable cash-flow situation, and I'm downgrading expectations. I think the economy is tanking."

STEPHEN SPOONAMORE
CPR-Group,
a design studio located
in New York

"In business, I don't think you can wait. You have to make positive moves to make things happen. I want to respond, but I just wish I had a crystal ball."

JOANNE BROOKS
Creative Impact Group,
an event planner
based in Deerfield, Ill.

"The phones are ringing all day. Interest in our technology is suddenly going through the roof. We've received enough interest to potentially double revenues."

JACK HERMANSEN
Language Analysis Systems,
a security-related software
developer in Herndon, Va.

"For a long time, the biggest thing we had to endure was educating business on the benefits of Web conferencing. Now it's very obvious. And we are so ecstatic."

SCOTT MOULE
SpartaCom Technologies,
a Web-conferencing
company in Tucson, Ariz.

Stretched-
Chojnowski is
faced by a funding
holdup, but revenue
growth is strong



indefinite hold. "It was a major setback," Chojnowski says. His employees faced a stark choice: either take a 25% pay cut, or risk being laid off. Then he began negotiating with his vendors. Though he still hopes that his investors will come through, he has begun exploring merger possibilities. Fortunately, Chojnowski says he's still experiencing strong revenue growth—about 20% a month—enough to carry CoolCall for now.

staying alive

How to remain afloat until the recovery begins

- 1 conserve cash** Prepare a detailed cash budget for the next three months, and stick to it. When deciding to spend, if you can't see an immediate benefit, it's probably not worth the cost.
- 2 avoid debt** Faced with a crisis, many entrepreneurs take on debt "just in case." But that only adds to your fixed costs. If possible, manage with belt-tightening.
- 3 review your customers** Verify creditworthiness before making a sale. Collect outstanding accounts, and stop selling to people who can't pay. Lock in long-term contracts with valued customers.
- 4 redouble sales efforts** This is the wrong time to cut marketing. Be inventive: If you can't afford to advertise, think of other ways to get your name out there.
- 5 be wary** Slumping economies often see a "false bounce." Don't ramp back up until you have a backlog of business.

Few entrepreneurs are so fortunate. Since September 11, big companies have capped spending or started consolidating vendors to cut costs. For small businesses, that could spell disaster. "Within two to five days of no sales, small companies could be close to out of business," says Joe Scharfenberger, executive vice-president of small business financial services at J.P. Morgan Chase & Co. "They are so hand-to-mouth that if they lose sales and still need to pay their staff, they could be in a negative cash-flow situation."

unexpected benefits

CRISES ALSO HAVE A WAY of creating opportunities. Michael Beirne, a 29-year-old entrepreneur and army reservist, went from winding down his business to bracing for big growth within the space of one dizzying week. Beirne's company, Novaforge Inc., is an e-commerce and information-technology security consulting firm that he launched in August. He was expecting to end the year with sales of \$250,000. Then, within days of the September 11 attacks, he was called to active duty and assigned to the newly-created homeland defense unit. Beirne decided he had no choice but to temporarily close shop and let his employees go until the Army released him from service. "It was disheartening and disappointing," he says. "But being an entrepreneur and an officer are both part of me."

A week later, everything changed again. Clients suddenly flooded Beirne with inquiries about beefing up their IT security. He had more work than he could handle. In a matter of days, he was projecting \$500,000 in revenues by the end of the year and had hired two new employees. And although Beirne admits it will be tricky to monitor Novaforge while on duty as an Army captain, he is confident his "top-notch" staff is up to the task. "I'll be tackling two tough missions," he says. "That'll be fun."

The trying times have been good for Lynne Leahy, too. Her 13-employee company, AquaPrix, distributes distilled drinking-water filtration systems to companies and has annual revenues of \$2 million. Since September 11, inquiries have jumped 30%. AquaPrix' system attaches to the water supply inside of office buildings, reducing the risk of outside contamination. "All companies are looking at security now," says Leahy, 57. She just launched a new direct-mail campaign and expects to close 2001 with \$3.5 million in revenues, 40% more than first forecast. She's pushing into the residential market and plans to add four or five new employees over the next six months. Expansion is far from a sure thing—especially if the nation's current state of alert should subside. But at a time when the only certainty is uncertainty itself, it seems as safe a bet as any.

@SB To read about how other entrepreneurs are coping with the aftermath, click Online Extras at smallbiz.businessweek.com

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AT A GLANCE

WHO: Spencer Williams, 28
COMPANY: West Paw Design
WHERE: Bozeman, Mont.
REVENUES: \$2.6 million
EMPLOYEES: 50
THE PRODUCT: Handcrafted fleece-fabric toys for pets
THE MARKET: Pet stores in the U.S., Canada, Japan, Britain, and Germany
QUOTE: "I really wanted to make something tangible and personal"

Pet Project

Five years ago, Spencer Williams' pals brushed off the tiny business he had bought as a "cute idea"—hand-sewn fleece toys for cats and dogs. But to Williams, it was also a brilliant opportunity: "I knew this was a great market with growing demand and something I'd really enjoy producing," he says.

Williams' first job out of Vermont's Middlebury College was selling financial research. He tired of it after a year. Borrowing from family, he bought a local pet toy operation with \$400,000 in sales and 20 products. Today, West Paw has a new factory and \$2.6 million in sales to more than 1,600 retailers. Its 120 products, still hand-finished (and still cute), include leopard-print "jungle bones" and fluffy, beady-eyed "hairballs." What's behind this pet-trepreneur's success? Jennifer Braxton, the buyer for Braxton's Animal Works in Wayne, Pa., credits quality materials and workmanship. Then, too, there are Williams' testers—his cat, Ollie, and his Labrador, Schoggi. How they take to a new product always gives Williams something to chew on. —NAWEEN A. MANGI

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**BUSINESS WEEK /
ARCHITECTURAL RECORD
AWARDS**



Good Design— And Good Business

The winners of the fifth annual *BusinessWeek/Architectural Record Awards* contest are standouts: architects and their clients who collaborated to create buildings with purpose and value. The range of winning entries is astounding—from the glitzy U.S. headquarters of a leading fashion house to a retaining wall that doubles as a mortuary at a Buddhist temple in Japan.

All, however, share a common understanding that a grand architectural gesture can say as much about a group's values or brand as any written mission statement, advertising campaign, or lobbying effort. A top-notch advertising agency, for example, designed its marketing office so that it inspired—and even honored—the firm's creative employees, while an environmental

group packed so much state-of-the-green technology into its new headquarters that it amounted to nothing less than a statement of ethical purpose.

These awards, sponsored by the American Institute of Architects and two publications owned by The McGraw-Hill Companies, are special because the jury includes both businesspeople and architects. To win, an applicant must show how architectural solutions to thorny business problems can achieve measurable results—in other words, how good design really does prove to be good business. Whatever

their values, this year's winning entries, which are described on the following pages, display a respect for creativity, beauty, simplicity, harmony—or whatever driving force is at their core.

By Gerry Khermouch, with David Rocks

*For the winners,
architecture reflects
the organization's
values*



In From The Cold



SAP knew that changing its image—from a specialist in arcane software to a global brand that helps managers solve knotty business problems—called for dramatic steps. So it recruited Sony Corp. veteran Martin Homlish to run global marketing and allowed him to shift operations from sleepy

Walldorf, Germany, to New York's Greenwich Village, where he angled for eye-catching digs that would make a strong brand statement. Homlish wanted an office that would help attract and retain talent, while serving as a stage for product launches, analyst briefings, and other events once held at expensive outside venues. Visitors to the renovated warehouse follow a translucent curved wall to a "plaza." Radiating out from the plaza are cylindrical work islands that staffers can configure as they see fit. For a company with an image of cold German precision, "it's a rather warm-feeling structure, a very interesting and pleasant space," says juror Thomas H. Davenport. It's also a prototype for future SAP offices around the world.

Radiating out from the central "plaza" are work islands that staffers can configure as they see fit—making for "a rather warm-feeling structure"





GLOBAL MARKETING HQ.
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BUILDING TYPE Marketing offices for a
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Through the Looking Glass

Corning Inc. faced a complex aesthetic challenge: to rehabilitate a glass center, featuring exhibits and a glass-blowing factory; dramatically redo a nearby landmark glass museum built in 1951 by famed architect Wallace Harrison; and create a new entranceway that would link the two. The project reflected the company's decision to combine the two centers, located in Corning, N. Y., into a single non-profit cultural facility dedicated to the art of making glass. The result: an elegant complex that is a celebration of glass. Special features include a glass-walled, 80-seat orientation theater and building lobbies with glass overhangs and walls held in suspension by stainless-steel fittings. "There's no small metaphor for the use of the shimmering, glowing, alive material of glass to make this a welcoming place," says juror Chee Pearlman. As a result of the new design, attendance is growing again after years of decline.



Corning's glass center and glass museum were linked by a new entryway, resulting in a single cultural facility that is a celebration of glass

CORNING MUSEUM OF GLASS

Corning
CLIENT Corning Inc.
ARCHITECT Smith-Miller + Hawkinson
 Architects, New York
BUILDING TYPE Glass museum

The New Lap of Luxury



LVMH Moët Hennessy Louis Vuitton, with its stable of luxury

brands like Dom Pérignon, Louis Vuitton, and TAG Heuer, wanted to consolidate its various New York offices into a flagship that would serve as a "cultural manifesto." It did just that. On high-profile 57th Street, LVMH's chiseled gem breaks the mold of lackluster, blocky towers that look as if they were designed by a city zoning official, not architects. Like fashion, the beauty is meant to be externally arresting. That means a faceted exterior melding three kinds of translucent glass to atten-

uate reflections of a nearby black tower while diffusing natural light inside. "This is a building that stops people in the street," says juror Gary P. Haney. It "has raised expectations about what architecture can do," says another juror, Terence Riley.



LVMH wanted to consolidate its various New York offices into a flagship that would serve as a "cultural manifesto." It succeeded admirably



LVMH TOWER

New York

CLIENT LVMH

ARCHITECT Atelier Christian de Portzamparc, Paris

BUILDING TYPE U.S. offices for the luxury-goods marketer



Substantive Style



Many advertising agencies too hard to be cutting edge when designing their headquarters and end up with spaces bordering on the wacky. No

Wieden + Kennedy. It converted a historic warehouse in Portland, Ore., into airy, cubicle-free workspace that conveys a sense of solidity in addition to encouraging creativity. Invitingly open, the building boasts a 400-seat amphitheater



n + Kennedy converted a historic warehouse into an airy workspace that conveys a of solidity and encourages creativity

ning room, a gym, and a café. The beyond comfortably housing 500 employees, is to stimulate collaboration and inforce the agency's position as a ive hub. "It's a substantial architecte- rather than a series of visual gimmicks or iconic gimmicks within the e," says juror Charles B. Rose.

WIEDEN + KENNEDY HQ

and, Ore.
INT Wieden + Kennedy
HITECT Allied Works Architecture,
 and, Ore.
BUILDING TYPE Office for ad agency



The glass exterior of this Phillips Plastic's factory lets workers see the nearby lake and woods

Room With a View



For a factory producing custom-molded plastic parts, Phillips Plastic sought a design that reflected both its rural roots and its open culture. The result was an 85,000-square-foot structure of glass, steel, and rough- and smooth-cut Mankato-Kasota Stone, a dense sandstone

native to the region. The building's floor-to-ceiling glass walls give employees views of the wooded site and Elk

Lake beyond. A 17-foot-high acoustic glass wall is all that separates the production area from offices, facilitating contact between managers and workers. The plant's design has helped increase on-time deliveries by nearly 10% while also boosting employee morale.

CUSTOM-MOLDING FACILITY

Phillips, Wis.
CLIENT Phillips Plastics, Phillips, Wis.
ARCHITECT Krueck & Sexton, Chicago
BUILDING TYPE Manufacturing plant for plastic components





Green-And Enviably



The Chesapeake Bay Foundation, an environmental advocacy group, knew it would be held to a high standard by employees, donors—and antagonists—when it elected to build its headquarters on 31 prime bay-front acres. So it plowed nearly one-fourth of the \$7.2 million budget into making the 32,000-square-foot wood and metal-siding structure a “green” showcase. The building uses only 10% of the potable water and 30% of the energy of a conventional office of that size, and 85% of the site was left undisturbed. While not every builder will shell out that much green to be green, “The Foundation is eating their own cooking,” says juror Mark Walsh.

The building uses 30% of the energy of a conventional office of that size

CHESAPEAKE BAY FOUNDATION HQ.

Annapolis, Md.

CLIENT Chesapeake Bay Foundation

ARCHITECT SmithGroup, Washington, D.C.

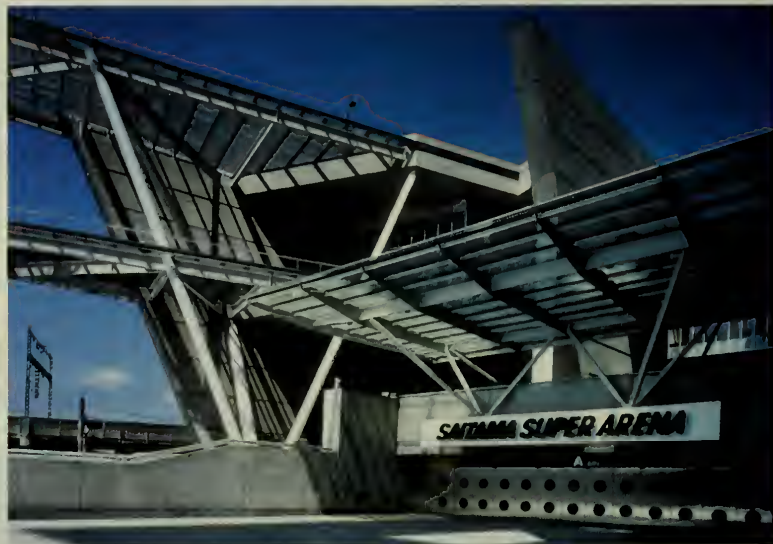
BUILDING TYPE Offices for nonprofit environmental organization

Spacing Out



It figures that space-constrained Japan would be the site for an unusually versatile “super arena” that can snugly accommo-

date a basketball game drawing 5,000 fans, then be quickly expanded into a football stadium seating 30,000. At the heart of the 500,000-square-foot “smart” arena in Saitama, a suburb north of Tokyo, is a moveable block of 9,200 seats, plus lavatories, concessions, and walkways. The seats can be shifted 230 feet in just 20 minutes, expanding or contracting the arena as needed. Throughout the stadium are also clusters of retractable seats, giving the place the flexibility to host



The key is a block of 9,200 seats that can be shifted 230 feet in 20 minutes

everything from trade shows to rock concerts to a visit from the U.S. basketball “Dream Team” en route to the Sydney Olympics.

SAITAMA SUPER ARENA

Saitama, Japan

CLIENT Saitama Prefecture

ARCHITECT Nikken Sekkei, Tokyo; Ellerbe Becket, Kansas City, Mo.

BUILDING TYPE Multi-use sports arena

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Lesson In Thrift



PEDESTRIAN BRIDGE

New York

CLIENT The Rockefeller University

ARCHITECT Wendy Evans Joseph Architecture, N.Y.

ENGINEER Heidinger Associates Inc., N.Y.

BUILDING TYPE Walkway connecting housing and laboratories

In architecture, less is often more. Such is the case with a novel pedestrian bridge that allows residents of a Rockefeller University faculty housing tower to amble over to labs across the street without having to dodge traffic on New York's hectic FDR Drive. The bridge, with a 100-foot span cantilevered from a single structure, was one-quarter the cost of a more conventional structure. And it preserved coveted river views.

Spiritual Utility

Japan's Kuhonji Temple faced a crisis: Local authorities, fearing a landslide, ordered its sloping burial ground to be demolished and a retaining wall to be put in its place. The temple responded in an innovative way. The wall doubled as an ossuary, housing not just the 100 existing tombs but 300 new ones, which were sold to finance construction. A new hall for weddings would generate funds for a sacred pond, a Buddhist motif. The architects thus "made this an extension of a belief system," says juror Chee Pearlman.



KUHONJI BUDDHIST TEMPLE GATE AND OSSUARY

Sasebo, Nagasaki, Japan

CLIENT Kuhonji Buddhist Temple

ARCHITECT Furuichi & Associates, Tokyo

BUILDING TYPE Buddhist Temple



Forget 'Out With the Old'

Dulwich Picture Gallery, founded in 1811, was a superb building in desperate need of restoration—and expansion. Now, it's a magnificent complex in London that

sensitively meshes the glory of the arched brick building with new additions. Updated lighting, climate control, and visitor amenities such as a 60-seat cafe have helped double attendance. As this case shows, "the solution is not always more architecture," says juror Terence Riley of the Museum of Modern Art.

DULWICH PICTURE GALLERY

London

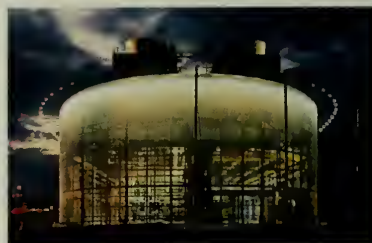
CLIENT Dulwich Picture Gallery

ARCHITECT Rick Mather Architects, London

BUILDING TYPE Art gallery

A Water Plant Flowers

It might have spelled design disaster: erecting a 20,000-ton water plant at a key entry point to the University of Pennsylvania. Instead, the university viewed it as a chance to create a visual gateway. The plant was wrapped in a perforated steel screen that shimmers in the sun and becomes a translucent, glowing totem at night. Against the odds, it has become an instant landmark. "There's something about it that just makes you want to love it," says Terence Riley.



WATER PLANT

Philadelphia

CLIENT University of Pennsylvania

ARCHITECT Leers Weinzapfel Associates, Boston

BUILDING TYPE Chilled-water plant

BusinessWeek / Architectural Record Awards 2001 jury: CHARLES B. ROSE, Principal, Charles Rose Architects, Cambridge, Mass. (jury chairman) SUSAN CANTRELL, Research Fellow, Accenture, Cambridge, Mass. DAVID M. CHILDS, Principal, Skidmore, Owings & Merrill, New York NEIL FRANKEL, Principal, Frankel + Coleman, Chicago THOMAS DAVENPORT, Director, Institute for Strategic Change, Accenture GARY HANEY, Design Partner, Skidmore, Owings & Merrill CHEE PEARLMAN, Co-Chair, Chrysler Corp. Chrysler Design Award TERENCE RILEY, Chief Curator, Department of Architecture and Design, Museum of Modern Art, New York WILLIAM R. SIMS, Professor, Department of Design and Environmental Analysis, Cornell University, Ithaca, N.Y. MARK WALSH, Chairman/Chief Strategy Officer, Vertical-Net, Horsham, Pa. ROBERT T. WALSTON, CEO, Liberty Livewire, Santa Monica, Calif.

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Tianjin, People's Republic of China, 28 November 2001



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Featured Speakers

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Mayor of Tianjin, China

Mark Clifford
Asia regional editor, *BusinessWeek*
Hong Kong

Li Yong
chairman, Tianjin Economic-Technological
Development Area (TEDA)
Administrative Commission, China

Laurence Brahm
managing director, The Naga Group
and author, "China's Century: The Awakening
of the Next Economic Powerhouse," China

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EDITED BY OTIS PORT

WHAT'S NEEDED FOR TEENSY-WEENSY CELL PHONES

THE CHIPS INSIDE CELL phones keep getting smaller. But the phones' size seems to be frozen, especially for multimode models that work on different continents. The reason is simple, says Clark T.C. Nguyen, an electrical engineer at the University of Michigan. Radio-frequency (RF) filters still hog a lot of space on the phones' circuit boards.

These quartz and ceramic filters grab a specific frequency for your phone calls while blocking all the others. They can vary in size, but often measure about 2 by 2 centimeters—and you need several to receive and transmit. Plus, if your phone is designed to function in different countries, it requires multiple sets for each format.

Nguyen says that he can shrink the filters way down by using the same fabrication technology that turns out tiny airbag sensors in automobiles. The technology carves mechanical devices in silicon gizmos known as microelectromechanical systems (MEMS). "It's the IC [integrated circuit] revolution for mechanical stuff," says Nguyen, who was once part of a team of scientists that road-mapped future communications for NASA. Now he has formed a start-up, Discera Inc., to make MEMS filters for cell phones.

To be sure, there will be some challenges, including the vacuum packaging required for such devices. But ultimately, says Nguyen, the MEMS parts could be integrated with the silicon circuitry. Once that is achieved, cell phones will shrivel to the size of watches, or even finger rings.

Neil Gross

NANO MAGNET, BIG BREAKTHROUGH

TATIANA MAKAROVA WANTED TO CREATE A SUPERCONDUCTOR by tightly packing tiny carbon buckyballs into sheets that resemble bubble wrap. Instead, the Russian physicist stumbled on what could be a far more important discovery: a carbon magnet that works at room temperature. Until now, metal-free molecular magnets were mainly cryogenic curiosities, working only at a frigid -255C or below. But Makarova's nano bubbles stay magnetic all the way up to 200C, according to her report in the Oct. 18 issue of *Nature*.

Buckyballs are about one-millionth as fat as a human hair. If they can be applied as magnetic coatings, the amount of data that could be stored on hard drives might jump 5,000-fold, to 30 trillion bits per square centimeter. That's enough to hold roughly 10,000 encyclopedias.

Why the bubble-wrap configuration retains its magnetic properties at room temperature is a mystery, says Makarova, who is based at Ioffe Physico-Technical Institute in St. Petersburg but is working on nano bubble magnetism with a team from Sweden's Umea University. The group hopes that understanding the basic physics will lead to advances in electrical and electronic devices. ■

A NOVEL TOOL UNFOLDS FOR PROTEIN RESEARCH

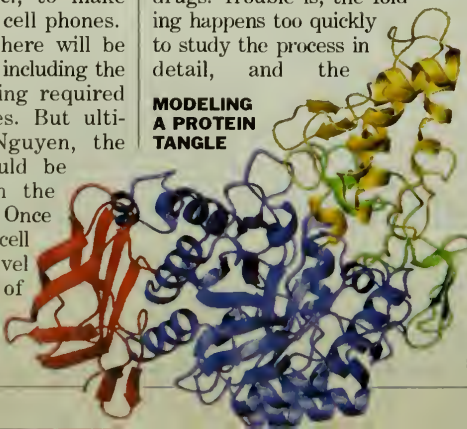
PROTEINS ARE THE BASIC structures of life: What they do in our bodies depends on their shape. If a string of amino acids folds one way, it may become an essential enzyme. A different shape, however, may form a protein associated with a genetic disease such as cystic fibrosis.

Researchers around the world are struggling to understand the dynamics of protein folding because it's the key to designing new wonder drugs. Trouble is, the folding happens too quickly to study the process in detail, and the

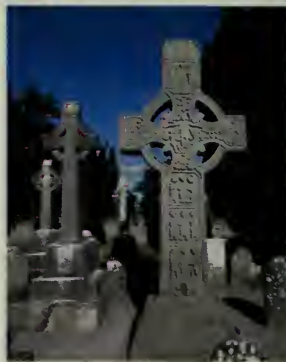
dozens of amino acids in a protein chain can fold into so many complex three-dimensional shapes that even supercomputers strain to simulate all the possibilities that might prove valuable. To narrow the problem, researchers assume each amino acid prefers to be surrounded by certain other molecules, then they program a computer to search for the best overall "fit."

Now, there's a more accurate shortcut. A team at Pennsylvania State University, led by physicist Jayanth R. Banavar, has developed a so-called neural network system that does a better job of predicting protein structure by mimicking the brain's circuitry. When Banavar's system was tested—by feeding it data on 213 amino-acid strings—the neural network correctly predicted the shape of 190 of the resulting proteins. As Banavar's team will report in an upcoming issue of *Proceedings of the National Academy of Sciences*, existing software tools accurately predicted only 137 of the final protein structures. ■

MODELING A PROTEIN TANGLE



INNOVATIONS



■ Even when Halloween rolls around, Thomas C. Meierding has no fear of graveyards. In fact, cemeteries are one of his favorite haunts. The University of Delaware geomorphologist studies tombstones for clues about environmental trends over the centuries. By measuring the difference between tops and bottoms of stone markers, he can judge how the stone has been eroded by air pollution and can compare urban vs. rural regions and different slices of history. Meierding has visited 700 cemeteries and compiled data on 15,000 tombstones. It shows just how corrosive urban air was in the 19th century, when factories spewed out black smoke from coal-burning furnaces—and how dramatically the destruction has slowed in modern times.

■ Could this be the ultimate car bumper? Surajit Sen, a University at Buffalo physicist, has designed a small megaphone-shaped structure filled with progressively smaller spheres. Energy that enters the wide end—the impact force from a traffic accident, for example—gets repeatedly diminished as it travels from sphere to sphere, exiting at no more than 5% of its original force. With lots of sufficiently long cones, almost any amount of energy can be absorbed, says Sen. The concept could even help bridges and buildings withstand earthquakes.

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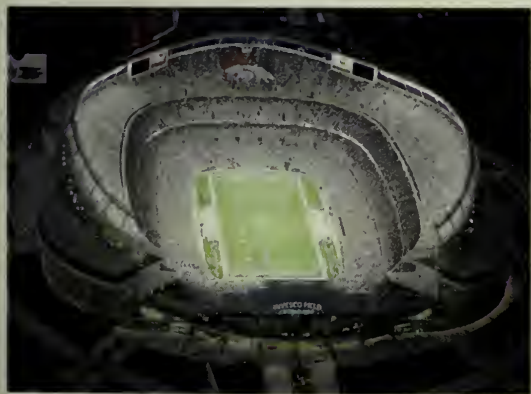
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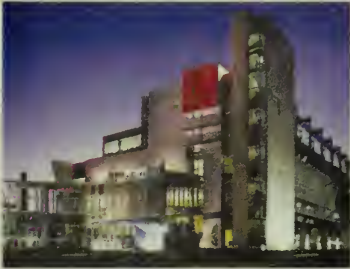
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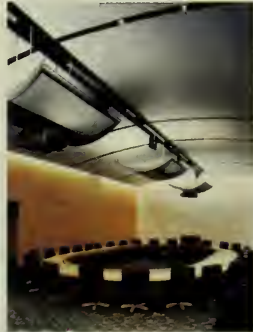
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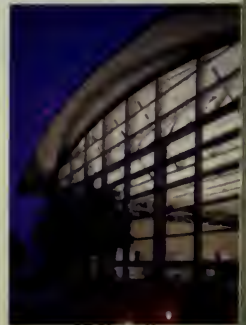
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The Olympic Club Renovation

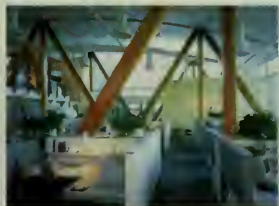


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MANUFACTURING

QUANTA'S QUANTUM LEAP

The Taiwan notebook maker's business could surge by 50%

When the U.S. halted air traffic for three days after the September 11 terror attacks, one of the many companies around the world caught in the downdraft was Quanta Computer Inc. With American airspace closed, the Taiwan contract manufacturer to Dell, Gateway, Hewlett-Packard, Apple, Compaq, and others couldn't get its notebook PCs across the Pacific. Finished computers were piling up in Quanta's cavernous warehouse in Linkou, 20 kilometers from Taipei. In the end, Quanta's managers improvised. They loaded thousands of notebooks on a plane leased by Dell Computer Corp., which flew them to Texas. And how did Quanta end up faring during Black September? Sales rose 20% year over year.

Even as other computer makers endure the worst crash in high-tech history, Quanta is on a roll, riding global demand for notebook computers to record double-digit sales increases. This year, it became the world's No.1 producer of

notebook PCs, passing Toshiba. "It's definitely a world-class company," says Tim Ariowitsch, an analyst with Goldman, Sachs & Co. in Hong Kong.

The force at the top of this Asian powerhouse is Barry Lam, Quanta's chairman and founder. Lam made the company what it is by building a supply-chain-management system that in the

notebook computer industry is second to none. To be sure, superstar Dell Computer Corp., which accounts for half of Quanta's sales, is the global master of just-in-time manufacturing and has pushed Quanta to maintain a high standard. But Dell's mobile-PC business didn't take off until it started working with Quanta's design and manufacturing team. Today the Austin (Tex.)-based PC maker relies on the Taiwanese company to produce 55% of its notebooks. With Dell and others steering more work Quanta's way, the company predicts revenues will jump as much as 50%, to \$3.6 billion this year. Merrill Lynch & Co. analyst Tony Tseng says profits will rise 30%, to \$320 million.

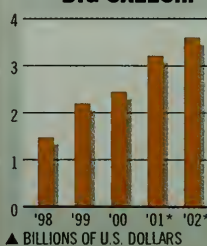
SHRINKING MARGINS. Quanta has the good fortune of being in the only hot segment of the computer business. According to International Data Corp., total PC sales in 2001 will shrink 10%. But notebooks are heading in the other direction, with International Data Corp.

projecting sales growth of 9% this year as companies and consumers continue to move away from clunky desktops. And Taiwan makes about 60% of the world's notebook PCs. Worldwide, one out of every seven notebook PCs comes from Quanta's factories.

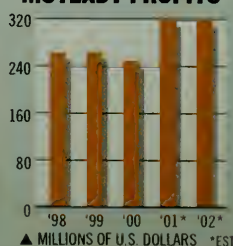
In the next few months, however, Quanta is likely to be tested as never before. Notebook sales cannot defy gravity forever, and other Taiwan manufacturers are copying Quanta's innovations in managing pro-

THE QUANTA MACHINE

BIG SALES...



...STEADY PROFITS



Data: Merrill Lynch

duction and logistics. Quanta's operating margins, which are now about 10%, compared with 18% a few years ago, are likely to continue to erode as competitors nip at Quanta's dominant position. For instance, local rival Arima Computer recently grabbed a big Compaq order from Quanta. And the proposed merger of Compaq with Hewlett-Packard should lead to even more price-cutting.

Moreover, other Taiwanese companies such as Acer Inc. have thrived as contract manufacturers, only to lose their footing as they reached for the next level. Ominously, Quanta's diversification strategy is looking shaky. The company's forays into mobile phones and Internet devices have yielded little profit. And the global tech recession has dampened demand for liquid-crystal display screens just when Quanta has invested \$153 million in a 31%-owned affiliate that makes the thin displays.

CLEAN HANDS. So to stay competitive, Quanta is selling itself as the contract manufacturer that does it all. By using Quanta's manufacturing and logistics system, customers can farm out the whole messy process of production and delivery without getting their hands dirty. Companies such as Dell still keep some of

the customizing work in-house, but others are willing to let Quanta handle that, too. Many clients "don't even see the computer," says production chief T.J. Fang. "They just sell their brand and collect the money."

One of those is HP. In 1999, it was on the verge of shutting down its notebook division when it decided to try Quanta. Now, the Taiwan company does just about everything for HP's notebook unit, from putting together hardware to installing software to testing the final product and shipping to customers—all in less than 48 hours. Outsourcing to Quanta "saved our business," says Jim Burns, HP's supply-chain director for notebook operations. "It was the biggest turnaround in HP's history."

The Net has a lot to do with why Quanta can fulfill HP's orders in just two days. Not long ago, brand-name computer companies placed a few big orders for thousands of one-of-a-kind PCs with Taiwan contractors, who assembled and delivered them over the course of weeks. But now, thanks to Web connections, orders flow 24-7 and consumers have greater freedom to customize than

KEEPING AHEAD: Rivals are copying Lam's innovations

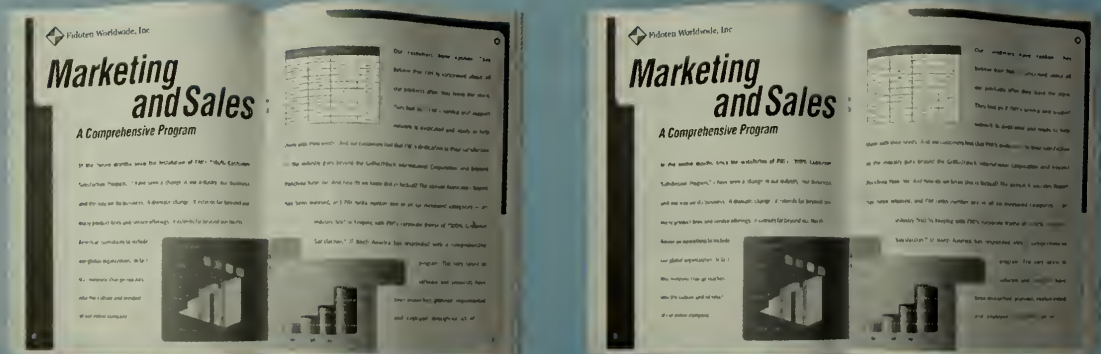
QUANTA IN PROFILE

- **FOUNDED** May, 1988, in Taipei \$900,000 in working capital.
- **CHAIRMAN AND FOUNDER** Bar Lam, 52, born in Shanghai, raised in Hong Kong, educated in Taiwan, he received his engineering degree from MIT.
- **EMPLOYEES** 5,200, up from 4,000 a year ago.
- **DIVERSIFICATION STRATEGY** Expand into everything from mobile phones and Internet appliances to servers and flat-panel displays.
- **LAM'S CORPORATE PHILOSOPHY** "We don't want to be a contract manufacturer—everybody can do that. The next trend is to be an intelligence-intensive company."

ever before. "We used to have one purchase order for 1,500 computers," explains Ted Wang, a deputy director on Fang's team. "Now, we have one purchase order for each machine." A year ago, Quanta promised to ship a computer within 72 hours of getting an order. Today, that's down to 48 hours. And 24 hours is the near-term goal.

Tracking all the orders in time re-

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Quanta puts out a 13-week schedule for its suppliers that it updates daily on its extranet. But sometimes even the best forecasts are off. "If any supplier has a problem," says Danny Lin, one of Quanta's top production managers, "it will destroy your plan." Then Quanta's managers have to make urgent phone calls to vendors, demanding that they rush over parts that afternoon.

LEFTOVERS. That puts pressure on suppliers, both big and small, as Panasonic Industrial Sales (Taiwan) Co. can attest. Panasonic supplies Quanta with DVD drives, batteries, and capacitors. By working more closely with Quanta, it has cut inventory levels in half, to 15 days. Still, if Quanta gets its forecasts wrong, Panasonic gets stuck with the leftovers, says Richard Shiao, general manager for info-tech systems at Panasonic Taiwan. "Unfortunately," he says with a weary smile, "we are the vendor."

Can Quanta keep leading a charmed corporate life? There's no guarantee—even for next year. The tech slowdown may eventually hit notebooks, and while outsourcing will likely increase, it's unclear how much more business Quanta can attract. "It already has all the major clients," says Merrill's Tseng. Worried about losses on the LCD investment, he sees no earnings growth in 2002.

In the longer term, Quanta faces a

challenge from China. So far, Legend Holdings Ltd. and other Chinese companies have thrived in desktops but not notebooks. But that situation is unlikely to last. To keep its lead, Quanta is building up its Taiwan-based R&D team—from 750 now to 2,000 by 2005—so that customers can outsource more of their design work to the Taiwanese. Another answer to the China question, Quanta execs say, is to take the just-in-time model to the mainland. Taiwan's government prohibits notebook companies from doing full assembly work across the Strait. But once Taipei lifts the ban—which is expected to happen soon—Quanta "will be very, very quick" to set up a Chinese production base, says Tim Li, Quanta's CFO. That could cut costs by 3%, a significant savings in an atmosphere of shrinking margins.

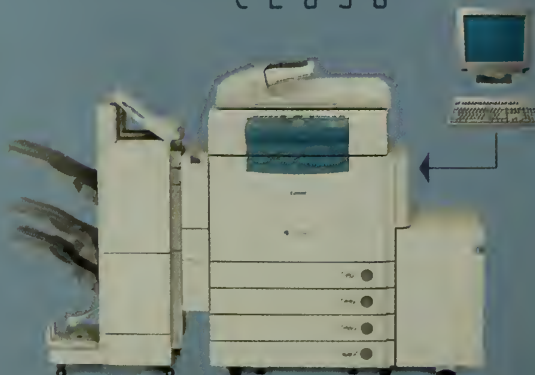
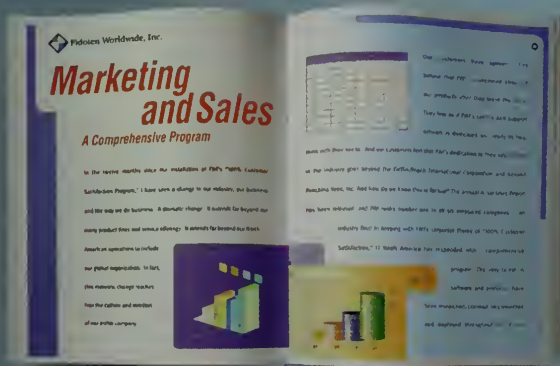
Chairman Lam knows he has no time to rest. He sees Quanta moving from its current 48-hour turnaround to 24. Getting there may involve distinguishing between ordinary orders and rush orders, says HP's Burns, who wants one-day turnaround by yearend. So far, Quanta has fought off the effects of the worst tech downturn in history. What happens next will determine whether Quanta retains its title as Laptop King.

*By Bruce Einhorn in
Linkou, Taiwan*

DAVID HARTUNG/LIAISON AGENCY

quires constant updating of Quanta's supply-management technology. A year ago, it took almost one working day for Quanta's production engineers to determine whether they had enough components on hand to fill all the orders they had received. Now, that's a one-computer job that takes two and a half hours. Relying on forecasts from customers, as well as in-house estimates,

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Khalid Al-Midhar came to the attention of federal law enforcers about a year and a half ago. As the Saudi Arabian strolled into a meeting with some of Osama bin Laden's lieutenants at a hotel in Kuala Lumpur in December, 1999, he was videotaped by a Malaysian surveillance team. The tape was turned over to U.S. intelligence officials and, after several months, Al-Midhar's name was put on the Immigration & Naturalization Service's "watch list" of potential terrorists. When the INS discovered in August that Al-Midhar was already in the

U.S., the FBI assigned agents to track him down.

By the time the FBI figured out where Al-Midhar was, downtown Manhattan was in flames, part of the Pentagon had been destroyed, and more than 5,000 people were dead. Racing to construct the disaster, agents pulled the manifest of hijacked American Airlines Flight 77—and discovered that Al-Midhar had bought a ticket for the flight using his real name.

As politicians, businesspeople, and terrorism experts try to prevent the horror of September 11 from ever being repeated, they are taking a closer look at the story of Khalid Al-Midhar. Could the tiny shred of information about him—his name and his image—have been used to thwart the attack? The answer may be yes. Technology exists that, had it been far more aggressively deployed, might have tracked down Al-Midhar before he stepped on board the plane. The FBI's list of potential terrorists, for instance, could have been linked to commercial databases so that he might have been apprehended when he used his Visa card days before the attack.

The videotape of Al-Midhar also could have been helpful. Using biometric profiling, it would have been possible to make a precise digital map of his face. This data could have been hooked up to airport surveillance cameras. When the cameras captured Al-Midhar, an alarm would have sounded, allowing cops to take him into custody.

The aim of these technologies is simple: to make it harder for terrorists to hide. That's top priority now—and it's likely to drive a broad expansion of

the use of intrusive security measures. Polls taken since September 11 show that 86% of Americans are in favor of wider use of facial-recognition systems; 81% want closer monitoring of banking and credit-card transactions; and 68% support a national ID card (page 86). But the quest for safety is also

things," says former Federal Trade Commissioner Robert Pitofsky, one of the most forceful privacy advocates in recent decades. "Terrorists swim in a society in which their privacy is protected. If some invasions of privacy are necessary to bring them out into the open, most people are going to say, 'O.K., go ahead.'"

Across a wide range of battlefields, privacy is on the retreat. Many high-tech surveillance tools that were deemed too intrusive before September 11, including the FBI's "Carnivore" Internet eavesdropping system, are being unleashed. Pre-attack legislation aimed at protecting people from unwanted privacy invasions has been shelved, while Congress is on the verge of passing an anti-terrorism law giving cops broad new powers to wiretap, monitor Internet activity, and peer into personal bank accounts. The notion of forcing citizens to carry a national identity card—once anathema to America's open culture—is getting

more serious consideration than ever in U.S. history.

These developments could wind up having profound implications for our democracy. Privacy involves the most fundamental issue in governance: the relationship of the individual to the state. Since the forefathers, Americans have been committed to the idea that people have the right to control how much information about their thoughts, feelings, choices, and political beliefs is disclosed. It's a matter, first and foremost, of dignity—creating a boundary that protects people from the prying eyes of the outside world. That, in turn, helps to shield religious minorities, political fringe groups, and other outsiders

COVER STORY

PRIVACY IN AN AGE OF TERROR

To track terrorists, government
snoops will have to track you, too

going to come at an incalculable cost to personal privacy. Any tool that is powerful enough to strip away the anonymity of Khalid Al-Midhar—one dangerous traveler among millions of innocents—will do the same thing to ordinary citizens. Their faces will have to be scanned by the same cameras, their spending habits studied by the same computers.

The war on terrorism is still in its early days, but one thing is already clear: In the future, information about what you do, where you go, who you talk to, and how you spend your money is going to be far more available to government, and perhaps business as well (page 85). "September 11 changed



from persecution by the majority.

By reducing our commitment to privacy, we risk changing what it means to be Americans. To the extent that ID cards, databases, and surveillance cameras help the government track ordinary citizens, they may make people marginally less willing to exercise basic freedoms—to travel, to assemble, to speak their minds. “It’s possible that through a tyranny of small decisions, we could make a nightmare society,” says Harvard Law School Professor Laurence H. Tribe.

Of course, we’re still a long way from that point. Although many civil libertarians worry that the era of Big Brother

HISTORIC SHIFT Congress is on the verge of passing a law giving cops broad new powers to wiretap, monitor Internet activity, and peer into personal bank accounts

But this is a rapidly evolving issue. We have already abandoned a number of old privacy taboos. If new attacks come and the U.S. is powerless to stop them, a mandate could develop for greater levels of surveillance. Here are some of the key areas in which personal privacy could begin to erode:

What You Do

No matter how hard terrorists try to keep a low profile, they live in the real world. The team that attacked the World Trade Center had to buy plane tickets, take flying lessons, communicate with one another, and draw money from bank accounts.

All of these moves leave traces on widely dispersed computer databases. That’s why the tool that probably has the most potential to thwart terrorism is data-mining. Think of it as a form of surveillance that casts its eye on computer networks. If cops could survey the nation’s computer systems and discover that a member of an extremist group also bought explosives and visited a Web site about building demolition, they might be able to halt a potential attack. Or if someone tried to purchase

anthrax, the seller could run an instant background check.

Today, those databases aren’t linked. The FBI’s watch list of suspected terrorists hasn’t even been connected to the INS or the State

Dept., much less the private sector. A wide variety of laws and taboos have prevented the government from hooking up its files with those of airlines, credit-card companies, and private data collection organizations. But that’s already changing: On Oct. 11, INS chief James Ziglar told a Congressional committee that he is moving to link the agency’s computers to the FBI’s central database of bad guys. He also wants to require air carriers to submit passenger lists to the INS to prevent suspected terrorists from boarding U.S.-bound planes.

Some people, including Oracle Corp. CEO Lawrence J. Ellison, are recommending the creation of even broader databases. Other industry experts, all of whom stand to profit from such a plan, argue that such vast systems are already feasible. For example, Wal-Mart Stores Inc. and Kmart Corp. have databases containing over 100 terabytes of information about everything from sales to inventory to deliveries. That’s the equivalent of about 200 billion documents—some 100 times larger than the Internal Revenue Service’s commercial tax-filing database. “There are

Cover Story

er is dawning, polls show that Americans are still committed to personal privacy and are unwilling to give law enforcers a blank check. President George W. Bush quickly dismissed the notion of a national ID card. And a coalition of left- and right-wing libertarians gave the Anti-Terrorism Act far rougher going than most commentators initially expected (page 88). Furthermore, none of the proposals currently on the table—such as installing facial-recognition systems at airports or linking the FBI’s databases to those run by the airlines—fundamentally threatens civil liberties.

NO PLACE TO HIDE

How new tools in the war against terrorism might affect your privacy

Surveillance

New technology makes it possible to keep a much closer eye on people in public places. Cameras equipped with facial-recognition software can pick out known criminals in a crowd at airports, stadiums, and public plazas.

Cars and cell phones equipped with location technology make it possible to track down people to within about 10 feet. Meanwhile, sophisticated X-ray machines that can see through people's clothes may be more widely deployed at airports, government buildings, and

even corporate lobbies. Many of these technologies have been stymied by privacy concerns in recent years. But now that fighting terrorism is the nation's No. 1 priority, their use is expected to increase.



X-RAY SCANNERS THAT SEE HIDDEN CONTRABAND ALSO SEE THROUGH CLOTHING

Data-Mining

Terrorists leave electronic footprints. What they buy, where they go, and who they talk to can all be recorded on credit-card, airline, and ISP computers. By using sophisticated software to analyze these databases, law enforcers think it may be possible to sniff out suspicious patterns of conduct — such as the purchase of anthrax by somebody who has visited a crop-dusting Web site. But while data-mining could be a potent tool, it also raises serious civil-rights concerns. The same software that looks for crooks will also analyze the activities of millions of Americans.

The Big Brother Scenario

Initially, these technologies would be deployed individually. But since they're all built on digital technology, it is possible to combine them. Think of it as surveillance convergence. National ID cards could be used to start a file on citizens. Data from Carnivore, government computers, and credit-card networks could be fed into that file. It could be linked to facial-recognition systems to allow the FBI to arrest someone on its terrorist list after detecting that the person bought potential bomb-making materials at a mall. Nobody is advocating this system. But it is technically achievable, and that scares civil-rights advocates.

Electronic Eavesdropping

Passage is imminent for the Anti-Terrorism Act, which gives the government much wider ability to eavesdrop on calls and e-mail. That won't affect most citizens. But the FBI is also making greater use of the controversial "Carnivore" system, which lets cops monitor what suspected criminals do on the Net. The problem is, it also gives lawmakers tons of data about innocent people. Deployment of Carnivore was largely stalled prior to September 11, but now the FBI is installing it on some ISPs.

National Identification Cards

Americans traditionally don't like the idea of national ID cards, which reek of authoritarianism. President Bush summarily dismissed the notion in September. Still, recent polls show that U.S. citizens are rethinking their aversion to carrying proof of citizenship. More than 100 other countries have ID cards, in-

cluding Spain, Portugal, Belgium, Finland, and Singapore. They come in many varieties: They can be issued to everybody or just to certain groups. People can be required to carry them everywhere or simply to present them before embarking on activities such as driving a hazardous-materials truck. They can be "dumb," such as a Social Security card, or "smart," such as a cred-



ID CARDS WOULD MAKE IT TOUGH FOR TERRORISTS TO POSE AS ORDINARY CITIZENS

it card. A digital version of an individual's fingerprint could be recorded onto a smart national ID card as a means of verifying identity.



AN ATM VIDEO CAMERA CAUGHT TWO SEPTEMBER 11 TERRORISTS ON TAPE

real-life data warehouses that absorb information in near real time, process it, and issue alerts within seconds or minutes," says Richard Winter, an in-

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dependent expert on large database systems.

A key challenge will be developing sophisticated software to sift through the databases, pinpointing likely terrorists and suspicious behavior. Working together, a team of criminologists and software developers would need to design profiles of potential evildoers. That has been done in the past to track down serial killers and to thwart hijackings with mixed results. The airline industry's Computer Assisted Passenger Screening system (CAPS) failed to pick out almost all of the September 11 terrorists. But there's good reason to believe the technology can improve. Software maker Sybase Inc.'s new mining software can already analyze up to 1,000 variables, vastly increasing cops' ability to find the needle in a haystack of personal data.

Of course, there are huge political and legal hurdles to launching such systems. For one thing, government officials have a long history of abusing their power to collect personal information. Remember J. Edgar Hoover and Richard M. Nixon? For another, databases created for one purpose have a way of being reused in unintended ways. Files that Massachusetts accumulated about citizen health insurance claims, for example, had to be turned over to the tobacco industry when the state sued cigarette makers (though the state took steps to ensure that individuals' identities were masked). Over the long term, widespread deployment of data-mining will depend in large part on the ability of law enforcers to persuade the public that effective guidelines can be designed—and followed.

Who You Are

One of the most controversial issues on the privacy landscape is that of national ID cards. Many Americans are instinctively repulsed by the idea. Passion runs so strong on this issue that the govern-

ment has repeatedly blocked efforts to use Social Security numbers for drivers' licenses, voter registration, and prison records. The fear is that the Social Security number would become the equivalent of a national ID card.

More than 100 other countries, many of them democracies, disagree. They come in many varieties. Germany, after the human rights abuses of the Nazis, takes a minimal approach. Cards contain basic information, including name, place of birth, and eye color. Malaysia, on the other hand, this year launched a project to issue 2 million "multipurpose" cards in Kuala Lumpur. A computer chip allows the card to be

gitimate alternative spellings, such as Jon Smith or John K. Smith—producing the same problem.

A national ID card solves this by turning every person into a reliable data point for entry into larger databases. Once national ID cards are in place, airlines, explosives manufacturers, and border-crossing guards will know exactly which John Smith they are dealing with. So terrorists will have a harder time passing themselves off as ordinary citizens. True, ID cards can be forged. But that problem can largely be managed via "smart" cards equipped with computer chips that can store the cardholders' fingerprints or

iris scans as biometric authentication devices.

The concern, of course, is that ID cards could lead the country down a slippery slope. Over the long run, say critics, they might be used as a platform for creating new databases. Starting with a card like, say, the one Malaysia just launched, governments could require the ID cards to be swiped into electronic readers every time people shopped, traveled, or surfed the Web and could accumulate an unprecedented quantity of information on their citizens.

For now, though, the question of a national ID card appears to be off the agenda, though it's nowhere near dead (page 90). Even some longtime civil libertarians are reevaluating. On Sept. 10, "I was a knee-jerk opponent of ID cards," says Harvard University law

professor Alan M. Dershowitz. "Now I've had to rethink the whole thing."

Where You Go

In recent years, scientists have made enormous advances in location-tracking tools. Surveillance cameras with facial recognition software can pick out criminals in public places. Global positioning satellite (GPS) transponders in cars, boats—and one day, in handheld devices such as phones—send out signals identifying people's latitude and longitude to within 10 feet. Both of these technologies will flourish in an environment free of many of the privacy concerns that clouded their future before September 11.

So far, facial-recognition systems are used primarily in highly controlled situ-

PRIVACY: WHAT AMERICANS THINK

Post-September 11, Americans favor expanding government surveillance powers

POLL OF 1,012 ADULTS SURVEYED BY TELEPHONE BETWEEN SEPT. 19 AND 24

	FAVOR	OPPOSE	NOT SURE/ OCCASION TO ANSWER
Use of facial-recognition technology to scan for suspected terrorists at various locations and public events	86%	11%	2%
Closer monitoring of banking and credit-card transactions to trace funding sources	81%	17%	2%
Adoption of a national ID system for all U.S. citizens	68%	28%	4%
Expanded camera surveillance on streets and in public places	63%	35%	2%
Law-enforcement monitoring of Internet discussions in chat rooms and other forums	63%	32%	5%
Expanded government monitoring of cell phones and e-mail, to intercept communications	54%	41%	4%

Data: Harris Interactive

used as a combination drivers' license, cash card, national health service card, and passport.

That's only the beginning of what's theoretically possible. Given the power of digital technology, criminal records, immigration data, and more could be packed onto ID cards. In fact, they could contain so much data that they become the equivalent of portable personal files.

That's still a long way off. From a cop's perspective, ID cards are desirable because they make anticrime databases work better. As things stand now, one typing error at the airline check-in counter—say, John Smith—and all the fancy efforts to unite Delta Air Lines Inc.'s database with the INS watch list don't add up to much. Forged drivers' licenses or passports—not to mention le-

ions as authentication devices, to such for the identities of workers entering, say, a nuclear power plant. They are not often used, especially in the U.S., as a general surveillance device in public places. Tampa police use them in high-crime districts. A few casinos have also installed them. But in the wake of the terror attacks, a security committee formed by Secretary of Transportation Norman Y. Mineta has recommended the aggressive rollout of facial-recognition systems in airports. But it's still unclear how useful they will be. They may still be tricked by people wearing fake beards. And they tend to generate too many false alarms. Unless these glitches get fixed, the devices may never be appropriate for high-traffic settings such as tunnels and bridges.

GPS is a different story. The technology works—and it has been rapidly spreading to new places. Before September 11, privacy groups and some legislators had been working to limit the ability of companies to collect location data from customers surreptitiously and to raise the legal standards for enforcement officials to subpoena this material. Those battles, for the time being, are stalling. If GPS information helps track down terrorists, it will be collected.

Whom You Talk To

Law enforcers need the ability to find out with whom suspected terrorists are talking and what they are saying. That's why the government lobbied for the Anti-Terrorism Act, which gives the feds increased powers to eavesdrop on telephone calls and digital communications made through e-mail, online service providers, and digital devices.

Unlike facial surveillance, ID cards, or data-mining—which invade everybody's privacy—the government's new eavesdropping powers will primarily target known suspects. So they don't raise as many issues for the public at large.

There's one major exception: Carnivore, a technology the FBI uses to monitor e-mails, instant messages, and digital phone calls. Carnivore generated widespread controversy before September 11 for being too powerful. When installed on a suspect's Internet service provider, it searched through not only the suspect's Web activities but also those of people who used the same ISP. After privacy advocates complained, the

FBI sealed back its deployment. Now, the brakes are off. There are widespread reports that the government has hooked up Carnivore to ISPs with minimal oversight. The government will probably soon demand that ISPs and digital wireless providers design networks to make them easier to tap. Just a few months ago, the FBI wouldn't have dared to ask. Now, such a move would barely make the papers.

Facial-recognition software. Data mining. National ID cards. Carnivore. For the near future, these technologies are going to be deployed as stand-alone systems, if at all. But we live in a digital age. All of these technologies are built

and the data-mining program detected a suspicious pattern of conduct.

Other, more futuristic new technologies could be added to the mix. Scientists will be able to make much more powerful surveillance devices if they're freed of the privacy concerns that have restrained them in recent years. Already, researchers are working on satellites that can read the unique color spectrums emitted by people's skin and cameras that can tell whether people are lying by how frequently they blink. Left unchecked, technologists could eventually create a nearly transparent society, says David J. Farber, a pioneering computer scientist who helped develop the Net. "All the technology is there," he says. "There is absolutely nothing to stop that scenario—except law."

To be sure, nobody is proposing such systems. And they are a long, long way from technical feasibility. But they are within sight—and no more far-fetched than, say, eBay Inc.'s auction-everything Web site was a generation ago. Indeed, unifying the various surveillance systems makes sense from a technological standpoint, and there's likely to be strong pressure, once the tools are in place, to try to make them work better.

As the U.S. enters the next phase of the war on terror, it is useful to keep this Orwellian scenario in mind, if only as a warning beacon of some of the hazards ahead. It is also reassuring to know that privacy principles developed in the past still apply in this new world. Surveillance can be checked by laws that require regular audits, that call for citizens to be notified when they're investigated, and that give people the right to correct information collected about



CONVERGENCE Facial-recognition software. Data-mining. ID cards. Carnivore. All of these technologies are digital, so they could be blended into one monster snooping system

on ones and zeros. So it is possible to blend them together—just as TVs, computers, video games, and CD players are converging—into one monster snooping technology. In fact, linking them together makes each one exponentially more effective.

A national ID card, for example, could be used to launch a new unified database that would track everybody's daily activities. Information culled from Carnivore could be stored in the same place. This super database, in turn, could be linked to facial-recognition cameras so that an all-points bulletin could go out for a potential terrorist the sec-

them. That's the best way of guaranteeing that, in our efforts to catch the next Khalid Al-Midhar, we don't wind up with Big Brother instead.

By Mike France and Heather Green in New York, with Jim Kerstetter in San Mateo, Calif., Jane Black and Alex Salkever in New York, and Dan Carney in Washington

BusinessWeek online

For more coverage of the privacy issue, see BW Online columns "Privacy Matters" and "Security Net" at www.businessweek.com/common/columns.htm

WHEN RIGHT AND LEFT SEE EYE-TO-EYE

An unlikely coalition of privacy defenders emerges

On Capitol Hill, it would be tough to find two more unlikely allies than Representatives Bob Barr of Georgia and Barney Frank of Massachusetts. Barr, a pro-gun conservative Republican, led the impeachment charge against President Clinton and sponsored legislation that lets states refuse to recognize

panded police powers in the bill. But civil liberties-minded lawmakers and interest groups aren't giving up the larger fight against overly intrusive government surveillance. They vow to seek curbs on law-enforcement agencies' existing abilities to collect and mine databases, plant cameras in public places, and use facial-recognition and other biometric systems to sniff out terrorists. "We will stay on the job," declares Schlafly. "We are very much against the government monitoring activities of law-abiding Americans, whether it's computers or video cameras or e-mail."

Cover Story

same-sex marriages. Frank, a liberal Democrat and acknowledged homosexual, defended Clinton with pit-bull intensity. But in the recent debate over the Bush Administration's anti-terrorism bill, Barr and Frank have stood together against the proposal. The reason: Both fear that the Bush bill could trample people's privacy by giving police more power to wiretap and spy on e-mail. "On these issues, we see eye-to-eye," says Barr.

So it goes in the strange-bedfellows privacy coalition that has given the anti-terrorism bill a far rougher ride than most Washington hands initially expected. And Barr and Frank aren't the only traditional foes singing the same tune. The post-September 11 privacy-protection coalition has been led by a broad spectrum of interest groups—ranging from Phyllis Schlafly's Eagle Forum and the Free Congress Foundation on the right to the American Civil Liberties Union on the left.

NO WAY. This diverse coalition has had modest success fighting the new measure. The Administration originally wanted the authority to detain foreign suspects indefinitely without pressing charges. No way, said Barr & Co. They were able to limit it to seven days. They also won a four-year sunset provision on the sweeping new surveillance powers.

Given the enormous public pressure to act quickly to fight terrorism, it's not surprising that the privacy coalition failed to blunt most of the other ex-



IN SYNC: CONSERVATIVE BARR (ABOVE) AND LIBERAL FRANK HAVE WORKED TO PUT LIMITS ON THE ANTI-TERRORISM BILL



HEADWAY An alliance including Phyllis Schlafly's Eagle Forum and the ACLU is bucking the Administration's plan to give police additional powers

Indeed, the prospect of cameras popping up on street corners and widespread use of facial-recognition systems gives privacy advocates of every stripe the willies. "We shouldn't roll these technologies out without carefully thinking through what the ground rules are," says David Sobel, general counsel for the Electronic Privacy Information Center, a leading civil liberties group. Using cameras for security checks of employees at government facilities is

one thing, says J. Bradley Jansen, deputy director at the Free Congress Foundation. "But cameras in public places are a gross violation of privacy without due cause."

"MUTUAL RESPECT." In fighting all the new tracking techniques, this diverse union of conservatives and liberals has stitched together a durable alliance. Conservatives, who distrust big government, and liberals, suspicious of government's power to stifle dissent, have joined forces repeatedly since the mid-1990s to protect privacy. They forced revisions in a 1996 anti-terrorism bill and thwarted police efforts to obtain a built-in backdoor to encryption software. "There is a great deal of mutual respect between the two wings of the coalition and mutual appreciation of the expertise of the two sides," says James X. Dempsey, deputy director of the Center for Democracy & Technology.

Alliance politics get complicated though, when the focus is corporate snooping. Among interest groups, there

a right-left divide on the need for commercial privacy curbs. Conservative groups, fearing government's heavy hand on business as well as on individuals, dismiss the need for federal online privacy rules. "Everyone on the right understands that because the government is a monopoly, there should be strong limits," says Grove Norquist, president of Americans for Tax Reform. "But it does not keep me up at night if I buy something from L.L. Bean and L.L. Bean sends me an e-mail about new pants I didn't ask for."

Traditional civil liberties groups, however, as well as many lawmakers, are still set to fight corporate snoops. "We need to stop the scoundrel who would make a business of your personal information," says Senate Commerce Committee

Chairman Ernest F. Hollings (D-S.C.), who is working on Internet privacy legislation.

Times have changed, of course, and the fight against terrorism has pushed debate about commercial privacy to the back burner. For the next few months the unlikely team of Barr & Frank will have its hands full defending privacy in a Capitol—and a country—grappling with fear.

By Amy Borrus in Washington



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COMMENTARY

By Lorraine Woellert

NATIONAL IDs WON'T WORK

With the public still shaken by the World Trade Center attack and spooked by a growing number of anthrax scares, the clamor for tighter security is growing. Suitcase searches, closed streets, and a cop on every corner just aren't enough to settle jittery psyches. So we keep looking for ways to reassure ourselves and to soothe complicated new fears.

One idea—a national identification card that presumably would separate law-

abiding citizens from dangerous infiltrators—is being promoted as a tool to reduce the threat of terrorism. But it's no silver bullet. A national ID card would rip at the fabric of our constitutional freedoms. It would cost billions and be technologically imperfect. Most troubling, it would lull the populace into a false sense of security.

First off, what would you need to get an ID card? A birth certificate and driver's license? Anyone—including terrorists—can obtain or alter such documents. Several of the men suspected of the September 11 attacks had forged identities. What would have prevented them from obtaining ID cards? And what of domestic terrorists Theodore Kaczynski and Timothy McVeigh?

To guard against counterfeiting, the card would need to

COMMENTARY

By Paul Magnusson

YES, THEY CERTAINLY WILL

Sorry, Lorraine, but the great debate over a national ID card has already been decided. We have 50 different varieties of driver's licenses. They're already required to cash checks, get a post office box, board an airplane, buy beer, register to vote, enroll in college, and even drive a car.

But our makeshift system isn't working very well. Most licenses are easily altered or counterfeited. They're dumb, too: Little or no information is encoded in bar codes, magnetic strips, or smart computer chips. They're a necessary nuisance, basically.

In the wake of September 11, people are being asked for a picture ID so often that the real question is no longer whether to have a national ID card. Rather, it's how to improve on our haphazard system without encountering huge expense or encouraging Big Brother to trample on the Bill of Rights.

RAISING QUESTIONS. The defense against terrorism provides a compelling argument for national ID cards that could be required for various transactions. At least two of the September 11 terrorists were on an Immigration & Naturalization Service watch list of suspects, and still they flew around the U.S., used credit cards, had bank accounts, cell phones, and frequent-flier memberships, and took flying

be encoded with biometric data such as a fingerprint, retinal scan, or blood sample—yet these come with high failure rates. "Biometrics are fallible," says Professor David J. Farber, a technology

expert at the University of Pennsylvania. He says fingerprints are reasonably good if you have an expensive reader. But hand readers fail frequently, facial recognition is rickety, and buggy, and retinal scans are costly. "If this is a fu-

FALSE SECURITY

To get an ID, you would need only show documents that could easily be obtained or altered.



lessons. National IDs might well have raised questions about the hijackers were buying airline tickets, since some had apparently overstayed their visas.

Ingenious new technologies could make ID cards more secure, useful, and palatable to civil libertarians. Smart cards similar to those embedded in subway fare cards can hold digital photographs, thumbprints, or even retinal scans for foolproof identification. That's useful for a leasing company being careful about renting its new crop duster. And when the company is running your card through its reader, it can check to see if your private pilot's license is up to date. It could have thoughtfully included that information as an option in order to save time (table). In fact, much of the information on a national ID card could be voluntary.

Actually, a national ID card is where emerging smart chip technology, consumer convenience, and the fight against terrorism can all come together. Having trouble remembering your blood type or medical-insurance prov-

defense, you can afford a lot of errors, but only if the errors that reject. If they're errors that accept, [they are] useless," he says. In any case, these systems rely on a nonforgeable ID card, and the technology in for that can be prohibitively expensive, adds Farber. Simple data-storage cards, at \$10 to \$35, don't come Multiply that by 280 million Americans. Add the cost of readers. Pay staff and overhead. The bottom line: a million-dollar system that will take years to deploy and a funded bureaucracy to operate.

Then there's the Big Brother problem. A national ID card eventually become as ubiquitous as the Social Security number and could be required for everyday life in the age of terror. Want to enter the Lincoln Tunnel to

WHAT THE GOVERNMENT MIGHT REQUIRE ON A NATIONAL ID...

Citizenship or immigration status

Home address

Voter registration

Record of felony convictions

Digital thumbprint

Digital photograph

...AND WHAT AN INDIVIDUAL MIGHT OPT TO ADD ON

People to notify in case of accident or death

Place to return card if lost

Employer

Blood type

Immunization records

Food & medicine allergies

Medical insurance information

Auto insurance information

Dental records

Pilot's license

Instructions for child custody

DNA profile

on the card for hospital emergency-room personnel to download on a reader employing a special encryption program for sensitive medical information. You might also be able to store drug allergies and data concerning your next of kin. All this is "technologically easy," insists Oracle Corp. executive Lawrence J. Ellison.

ACTION. Why not have a voluntary system? And keep the government out of it? Because to be secure, the government needs to be involved, just as the Bureau of Engraving & Printing has to add those special features to \$50 bills to make them so hard to duplicate. Seventy percent of Americans say their personal identification papers have been lost at one time or another. But a national ID card, protected by a 1,024-bit code, is impossible to break "with-

New York? Send a package? Register for school? Buy a computer? No can do without an ID card. "This will quickly become a mandatory system," says Barry Steinhardt, associate director of the American Civil Liberties Union.

CHECKS. Taken to the extreme, a smart card could record your ethnicity, religion, political leanings, or favorite cereal. And at every turn, government agencies, employers, banks, insurance and health-care companies, and grocery stores would pressure you to add data to your life-on-a-chip. A prospective employer using the card to check your citizenship might notice that you vote in Democratic primaries—since the ID is required when you go to the polls. Hmm, maybe you aren't a good fit for this company. What about that prescription you're taking to control schizophrenia—part of the medical record that your health-care provider insists must be on your card? Airport security might decide you're unfit to fly. "We need to very carefully think through what our objective is," says William P. Crowell, former director of the National Security Agency and head of Cylink Corp., a Santa Clara (Calif.) technology company. "Let's make sure...use of the card is limited to [that] purpose before moving ahead."

Therein lies the irony: The more robust the card is, the more faith the public will put in it. That, in turn, increases its vulnerability. "The more people assume the card is good, the less they will check you out, and the easier it becomes to slip someone past the system," says Professor Jonathan S. Shapiro of Johns Hopkins University. In other words, that false sense of security might only leave us more vulnerable to further terrorist attacks.

Woellert covers politics from Washington.

out a supercomputer working away for a hundred years," says Avivah Litan, a consultant at GartnerGroup in Stamford, Conn. "So a national ID card would actually enhance privacy by protecting against identity theft."

In Finland, for example, the government provides smart cards to authenticate the identity of someone transacting business over the Internet. The cost: just \$37, including a reader that connects to a computer in your home or office. Finns can add medical information to the cards, as well as use them to access their company's Intranet or to do their banking on the Internet.

The government also should be allowed to demand some data be included on the card. National IDs could be used to screen out felons attempting to purchase guns if criminal records were added. And smart ID cards could be required of all immigrants admitted temporarily on student, business, or tourist visas.

All this security can be had for a surprisingly small investment. GartnerGroup puts the cost per card at about \$8, while a commercial reader might run around \$50—well worth the cost to a business the first time it detects check or identity fraud.

The trick now is to fashion a national ID system that serves security while maintaining Americans' civil liberties. Thanks to technology, that's easier than ever.

Magnusson covers international economics from Washington.

SAFETY GAIN

Smart chips could make ID cards more secure—and palatable to civil libertarians

NEW YARDSTICKS FOR INVESTORS

SEC chief Harvey Pitt is determined to overhaul the nation's outdated system of financial reporting

At his Senate confirmation hearings in July, Securities & Exchange Commission Chairman Harvey L. Pitt pledged to set a new tone of cooperation between the agency and the markets and companies it regulates. Now he has started backing up his words with potentially the biggest shakeup in securities regulation since the SEC's birth in the depths of the Depression.

The new accounting for the 21st century could deliver big payoffs: more accurate stock valuations and less volatility in stock markets for investors, and cheaper capital for companies. "This will be transformative," says Brookings Institution economist Robert Litan.

Pitt is determined to break the stranglehold of earnings reports on the market's psyche. Quarterly and annual reports are "static...often stale," and "not

always capable of being deciphered by sophisticated experts, much less ordinary investors," Pitt told the American Institute of Certified Public Accountants. So he wants to throw the doors open for companies to augment today's earnings and asset numbers with far more information on their future trends and strengths.

The most radical change could be in the treatment of so-called "intangibles"—assets such as brands, patents, and staff know-how. Intangibles are crucial to today's successful businesses, but they're left off balance sheets now unless companies are bought or sold. Pitt also wants to encourage companies to issue current numbers, along the lines of weekly auto production or retailers' monthly sales, that give frequent updates on how businesses are performing.

Many companies love Pitt's ideas. New Economy and knowledge-based enterprises could present what they consider to be a fairer and more accurate view of themselves and where they're



headed. "We need to reach beyond the quarterly reports to provide more timely information and more context about future prospects," says David L. She larz, chief financial officer for Pfizer Inc. **POLICY REVERSAL.** Already, some companies report nontraditional measures. 3M Co., for example, highlights "innovation revenues," the 35% of its sales resulting from products introduced in the last four years. Under Pitt's plan, companies wouldn't

COMPANY, POLICE THYSELF

In 1976, the Securities & Exchange Commission was rounding up U.S. companies that fudged their books to conceal bribes paid to foreign officials. To speed up cases, the SEC announced an amnesty: turn yourself in, clean up, and we won't sue. The program netted hundreds of companies without much effort—a fact noted by a young SEC lawyer, Harvey L. Pitt.

Fast-forward a quarter-century to the first major enforcement action of Pitt's era as SEC chairman. On Oct. 23, the commission laid out guidelines for



LENIENCY: Pitt and the SEC will cooperate with companies that report fraud

companies that cooperate with investigators probing securities violations. For the first time, firms have a blueprint to minimize—or perhaps even escape—legal action by the agency.

The plan arises from a \$7 million accounting fraud allegedly committed by Gisela de Leon-Meredith, formerly controller of a subsidiary of food processor

Seaboard Corp. of Shawnee Miss Kan. According to the SEC, Meredith underreported the subsidiary's earnings from 1995 until early 2000. When Seaboard discovered her actions, promptly investigated, fired her two superiors, and cooperated with the SEC, even providing privileged documents. As a result, the agency sued Meredith—but not Seaboard. Meredith accepted the SEC's sanction without admitting the charges.

TONE CHANGE. The lesson, according to the SEC report on the probe: "When companies seek out, self-report, and rectify illegal conduct...investors can benefit more promptly." Cases will be finalized faster, satisfying Pitt's desire for "time enforcement." And the SEC stretches its thin resources. "The st

SHEDDING MORE LIGHT

SEC Chairman Pitt complains that financial reports are backward-looking, hard to understand, and don't highlight the information investors need. Some of the improvements he is considering:

INTANGIBLE ASSETS Items like patents and brands to human resources don't show up on balance sheets unless they're bought or sold. Book value differs widely between companies that make acquisitions and those that develop products internally. Rulemakers are struggling to figure out which assets belong on the books—and how they should be valued.

NONFINANCIAL FACTORS Human capital, customer loyalty, and product quality all contribute to the bottom line but can't be measured in dollars. Investors also need to know what products are in the pipeline. The SEC may push industry groups to develop standardized ways of disclosing such information.

MORE FREQUENT DATA Auto makers report weekly production, big retailers same-store sales monthly. Other industries could produce more timely numbers—if they get protection from investor lawsuits.

SLICE 'N' DICE Accountants are developing XBRL, a way of coding financial reports on the Internet, that will let investors download and manipulate companies' numbers any way they like.



required to report such numbers—but accountants would feel the heat from analysts and investors. “There’s tremendous value in giving the market guidance, so that estimates of what your stock is worth aren’t all over the map,” says Cary Klafter, director of corporate affairs for chipmaker Intel Corp.

Investors could gain, too. Overlooking intangibles handicaps shareholders, says New York University accounting professor Baruch Lev. His research shows

that insiders who buy and sell stocks at research-intensive companies collect capital gains three times larger than executives at other companies. Insiders capitalize on the fact that they know more than other investors about how R&D is paying off, Lev says.

Economists, accountants, and corporate executives have produced reams of research on potential new measures. What’s been lacking is a push from the SEC. “It’s a massive project, and somebody has to get it rolling,” says Robert K. Herdman, Pitt’s new chief accountant. “We’re intent on getting it done.”

Although their implementation will be complex, Pitt’s ideas share a common theme: Encouraging companies to volunteer better information that will help investors. His emphasis on carrots over sticks is a reversal from his predecessor, Arthur Levitt Jr. Faced with a runaway bull market, Levitt crusaded against the numbers games played by companies striving to hit targets for quarterly earnings. Ultimately, he went to war with accountants, whom he felt were turning a blind eye to financial shenanigans.

By contrast, Pitt, a longtime top defense lawyer for individuals and companies fighting the SEC, is reaching out with initiatives long sought by two groups of key Levitt antagonists. The day after he announced his accounting

push, the SEC gave securities lawyers a road map that their corporate clients can follow when they uncover accounting or securities-law violations. Companies that cooperate with SEC probes, the agency said, can hope to avoid enforcement lawsuits (box).

Like Levitt, Pitt decries the current mania for pro forma earnings—figures that purport to demonstrate how a company’s core business is faring by rearranging the official numbers or leaving out extraordinary expenses. But the trend, he says, carries an important message: “Investors [are] anxious for current, simplified, and comprehensible financial reporting.”

PUFF? The trouble is that Pitt’s push to address that issue could create a whole new set of problems. While companies want credit for their intangibles, accountants still have no agreed way of measuring them. Corporate America would balk at new reporting mandates—but the voluntary disclosures Pitt favors could invite companies to highlight favorable trends and downplay the bad. And firms say they need better protection from lawsuits before they’ll give more predictive information—a possible license to mislead the market, according to critics.

Pitt’s SEC thinks it can clear those hurdles. First, it doesn’t plan to scrap GAAP—the generally accepted accounting

“There are plenty of really bad guys out there,” says William R. McLucas, a former SEC enforcement chief now at Wilmer, Hinde, & Pickering. “If they can increase the penalties, companies that self-police, investors reap an exponential benefit.”

But, so, say critics: The SEC blueprint sets a tone at the top of a lack of accountability,” says Lynn E. Turner, former SEC chief accountant. Lawyers who defend corporate miscreants are taking a blind-eye attitude. The SEC “hasn’t revised any quarter,” says one defense lawyer, particularly since it won’t be left if outsiders discover wrongdoing by the company does. But Pitt’s “no-look-the-future amnesty clearly signals a new approach—cooperation, not confrontation—for the SEC.

By Mike McNamee in Washington

principles that govern official financials. Instead, it hopes to improve GAAP by adding intangibles—a challenge that the Financial Accounting Standards Board will consider taking up in December. “We’ll never be able to quantify every asset,” says Edmund L. Jenkins, FASB’s chairman, “but we need to help investors understand which are crucial to the value of corporations.”

MINEFIELDS. To further its campaign, the SEC is likely to soon issue a white paper. Its goal: encourage auditors, companies, and investor groups to develop a consensus, by industry, on how to define the extra data—market share, say, or return on research spending—that serves shareholders best. Then, analyst

“Investors are anxious for current, simplified, and comprehensible . . . reporting,” says Pitt

and investor pressure will force companies to provide numbers consistently.

Emphasizing voluntary disclosure will help the SEC negotiate political minefields. Congress has encouraged the agency to look at New Economy measures. But a flood of new reporting rules would boost companies’ costs and raise political opposition—a risk that Pitt is

unlikely to take. Besides, voluntary and experimental programs can get rolling quickly—well within Pitt’s likely five-year term—while the SEC’s ponderous rulemaking could drag out much longer.

But he still faces tough foes. Pitt, a fan of the 1995 law that gave companies a safe harbor for forward-looking statements, will need to ask Congress to give companies even broader protection—possibly setting Corporate America against trial lawyers and investor advocates.

Whatever the headaches, Pitt is determined to push ahead with reforms. If he succeeds, the New Economy will get the new accounting its proponents have long wanted.

By Mike McNamee in Washington

COMMENTARY

By Heather Timmons

TERRORIST MONEY BY WIRE

Washington has enlisted banks in its all-out effort to find and stop terrorists’ sources of funding. They have responded by freezing assets and holding press conferences pledging their support. Nearly overlooked in the search for laundered money, however, are agencies that offer an easier, faster way to move cash around the globe than most banks.

The omission is glaring. Western Union, MoneyGram, and dozens of smaller outfits handle \$41 billion of international payments a year. The two dominate the business, and maintain well-kept databases of customers and transactions. Controls at the smaller outfits aren’t necessarily so tight, investigators say.

HOT SOURCE. Although all money transfer shops are required to report transactions over \$3,000, they are exempt from a host of money-tracking requirements that banks must follow, and they’re not subject to the regulatory equivalent of a Federal Reserve or Office of the Comptroller of the Currency. “No one was looking toward a Western Union as a hot source of money laundering,” says H. Rodgin Cohen, CEO of Manhattan law firm Sullivan & Cromwell and an expert on money-laundering issues. “Unfortunately, that’s not the case” with terrorism funds, he says. Already, Western Union has been linked to two transactions involving an FBI suspect in the September 11 disaster. A West-



SEARCHING: MoneyGram is combing its customer database

ern Union spokesman said that the company is “cooperating fully” with law enforcement.

A transfer agency’s appeal to terrorists is obvious. There’s no need to set up a bank account or apply for a credit card. Identification requirements are minimal: In most cases, a photo ID will do. Many agency outlets consist of a computer terminal in a supermarket, check-casher, or drug-

store, staffed by the store employees. It takes less than 15 minutes to send money around the world. Most banks take days.

New regulations aren’t going to close the loophole anytime soon. Legislation proposed before September 11 requires money-transfer agents to register with the Treasury Dept. by Dec. 31, but they’ll have up to nine months to comply with most new regulations. “This is the first effort to get a sense of who they are,” says a spokeswoman for the Treasury’s Financial Crimes Enforcement Network (FINCEN), which tracks terrorist funds. After regulators imposed similar registration rules on *bureaux de change* in the Netherlands, a third of them shut down.

For their part, the big shops say they’re eager to help. MoneyGram used a list of September 11 terrorist suspects published by CNN to check its customer database even before it was approached by the FBI. Both MoneyGram and Western Union have been filing Suspicious Activity Reports voluntarily since 1996. Transfer shops have uncovered money laundering rings based in Nigeria and Columbia, says FINCEN.

Still, the agencies are not yet being included in closed-door meetings between bankers and regulators. They clearly need to be—and fast.

Timmons covers banking from New York.

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LET THE BIDDING BEGIN FOR PROVIDIAN

The card issuer's woes go way beyond its high-risk customers

For much of the past decade, math whiz Shailesh J. Mehta's Providian Financial Corp. ran rings around rivals. By using everything from cable TV to the Net to troll for business and offering credit cards to students and other high-risk borrowers, he quickly turned Providian into the nation's fifth-biggest card company, with more than \$30 billion in loans outstanding. The company had a finger in the wallets of one in eight American households. Indeed, it was doing so well that it was sixth in *BusinessWeek's* annual ranking of the 50 best corporate performers.

Today, the sparkle is gone. Mehta is out as chairman and will remain CEO only long enough to find a successor—if one is named. And Providian is effectively on the block. The San Francisco company will “explore absolutely every option” to get a good return for shareholders, promises J. David Grissom, hurriedly appointed chairman on Oct. 18. They could do with a fillip: Shares have fallen 92% since July, to barely over \$4 on Oct. 24. But getting a lift may be hard without breaking up the company. “I would question whether this is a viable, going concern,” says Prudential Securities Inc. analyst Bradley Ball.

So now, the issue is: Who will buy Providian's loan portfolio, and for how much? Analysts figure Citigroup, MBNA, and Bank One—the three largest card companies—might be interested in its \$22.3 billion worth of loans to top- and middle-ranking borrowers, and Citi-



GRISSOM: The new chair may be forced to break the company up

group's Associates unit or Household Finance in its \$9.4 billion in subprime loans. Buyers might pay a 5% to 10% premium on the higher-quality loans, but they might want an incentive to take away the low-rated stuff, says Michael R. Hughes, a Merrill Lynch & Co. analyst.

Lately, times have been hard for all credit-card issuers as bankruptcies have risen, bad debts have mounted, and economic prospects have remained dim. But they have proved especially troubling for Providian,

whose charge-offs for uncollectible loans have climbed from 7.6% of assets last fall to 10.3% now and are likely to top 12% by yearend. For most companies, they're still below 5.5%. Worse, solvent customers are charging less and paying down debt. Mehta, who earned a PhD at Cleveland's Case Western Reserve University, partly by researching the math used in the credit-card industry, has complained that consumer purchasing has been well below expectations. After saying on Oct. 18 that he was “frustrated” by Providian's failures, Mehta refused to answer analysts' questions. He declined to talk with *BusinessWeek*.

In reality, Mehta's brainchild has been troubled for a while. For one, Providian's hard sell to high-risk customers at times may have crossed the line into hucksterism. Last year, it paid \$300 million to settle charges by the Comptroller of the Currency and the San Francisco District Attorney that it had “misled

and deceived” consumers with less than candid marketing. Officials claimed it telemarketers refused to specify promised “great savings” on interest rates and failed to spell out extra charges on “no annual fee” cards. Providian settled without admitting or denying the charges.

FUMING ANALYSTS. This year, Providian pulled in its horns. In March, it stopped running TV ads with 800 numbers to call to apply for credit cards. It ratcheted down a TV campaign for GetSmart.com, a financial Web site that offered cards with rates as high as 27.99%. It tried to pitch cards to upscale clients. But such moves were too little, too late.

When Wall Street got wind of the mounting problems, Providian's share price went into freefall (chart). In August, the company quietly revised its practices for writing off bad accounts, delaying the impact of customer bankruptcies for up to 30 days. Analysts fumed—and cut their earnings outlooks. Then, on Sept. 4, Mehta warned that this year's earnings will come in some 7% lower than expected. His resignation was the last straw. “They've lost their credibility with investors,” says Robert B. McKinley, CEO of CardWeb.com, which tracks the credit-card business.

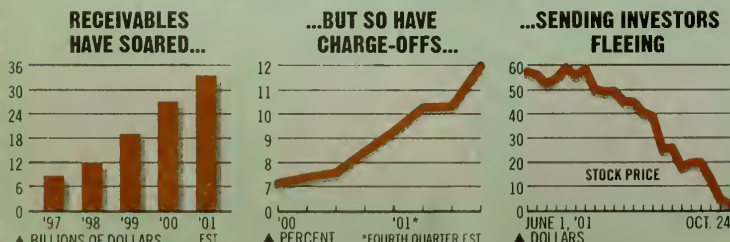
Now that his numbers no longer add up, Providian's math whiz faces a bleak future. Rather than breaking in a successor, he may have to decide which of his rivals will get the business he built.

By Joseph Weber in Chicago

MEHTA: Resigned the chairmanship on Oct. 18



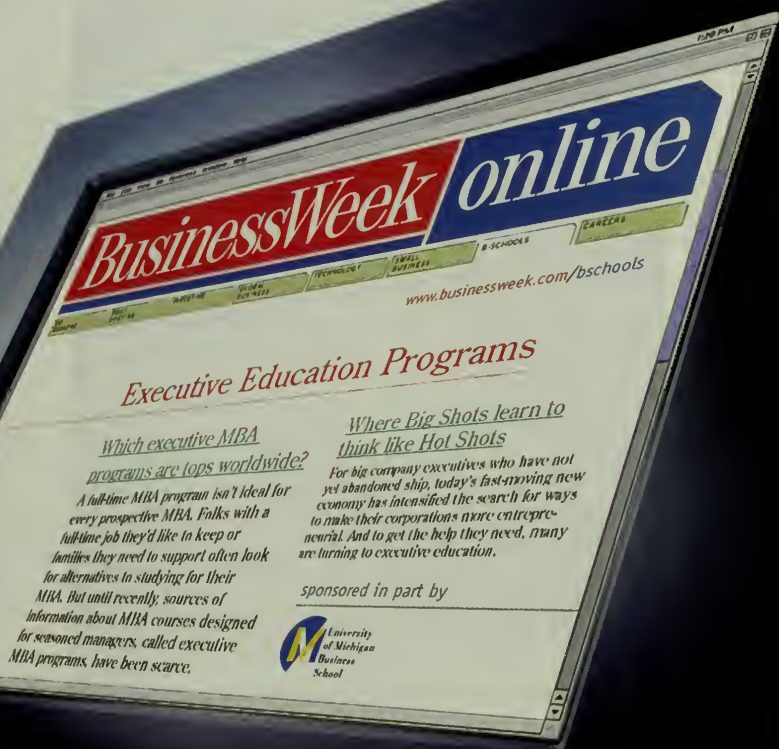
IMPROVIDENCE AT PROVIDIAN



Data: Providian, Prudential Securities Inc., Bloomberg Financial Markets

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CAN UTC GET BACK ON ITS FLIGHT PATH?

The conglomerate has made big changes—but still feels it gets no respect

For seven years, George A. David, chairman and chief executive of United Technologies Corp., has quietly built his \$27 billion conglomerate into an earnings powerhouse. With such marquee names as Otis elevators, Pratt & Whitney engines, Carrier air conditioners, and Sikorsky helicopters, the Hartford company efficiently churned out the profits. Despite its stellar performance, however, UTC never generated much buzz. Not only was the Old Economy conglomerate overshadowed in the '90s by a sexier crop of hi-tech stars, but David—an unflappable executive who rarely raises his voice—bristled at the sloganeering, spotlight-grabbing style of some execs. He was never a high-profile exec like General Electric Co.'s John F. Welch, for instance. As A.G. Edwards & Sons Inc. analyst Kent Newcomb puts it: "This is a fairly conservative, New England-type company that doesn't blow its own horn."

But after the bizarre events of the past year, it's clear David, 59, has some explaining to do. Suddenly, his growth strategy has been sent back to the repair shop. First, his plan to transform UTC into a bigger and bolder beast took a hit when former GE chief Welch stole away Honeywell International Inc. mere minutes before David could seal a union. Then, after UTC deployed a successful legal effort in Europe to help derail GE's \$45-billion deal in July, the terrorist attacks of September 11 sent some key units into a tailspin. While David wants to prove that years of prudent management and dealmaking will continue to pay off, the attacks ended a remarkable record of 28 straight quarters



Where UTC Is Hurting

DAVID: "Our instinct is fix or drop dead"

only meet expectations this time around. Still, that translates into a 14% jump in third-quarter earnings to \$565 million, on revenue of \$6.9 billion up 7%. David also confirms his earlier warning that the downturn could slice up \$250 million from fourth-quarter profits. Now David, a man who shies away from both confrontation and glad-handing, must convince investors that UTC can bounce back. He even seems a little bitter about those who bailed out on his shares: "I thought they might have cut us some slack."

BIG STEP. David points out that he has long been preparing UTC for this kind of crisis by working to improve its global reach and overall business mix. Says Partha Ghosh of Adventis, a Boston consulting firm: "He's made it lean and focused on what it does well." The challenge now is to keep that steady double-digit growth despite a volatile stock price and business downturn. That means more emphasis on the cost-cutting and productivity initiatives that have expanded margins in recent years, as well as more service business and strategic acquisitions to make up for lagging sales.

Indeed, UTC has already become a much different animal. Its CEO took a big step to improve the company's business

REVENUES*
IN 2000

DIVISION	PROBLEM	REVENUES* IN 2000
CARRIER	The broad economic downturn has dampened sales of air-conditioning and heating systems	\$8.4
PRATT & WHITNEY	Already trailing in large-engine sales, it saw service revenue fall as airlines parked planes in wake of September 11	\$7.4
OTIS	The falloff in construction activity means fewer elevator installations	\$6.2
HAMILTON SUNDSTRAND	Fewer plane orders cut demand for flight controls and other aerospace systems	\$3.2

* Revenues in billions

Data: Company reports, *BusinessWeek*

in which UTC beat Wall Street's expectations. And skittish investors initially fled, driving the stock price down 26% in the first day that trading resumed, on Sept. 17, compared with an 11% slide for GE.

On Oct. 16, David said that UTC could

mix in 1999 when he sold auto-pau maker UT Automotive for \$2.3 billion while paying \$4.3 billion for leading industrial and aerospace manufacturer Sundstrand Corp. That unit, which became Hamilton Sundstrand, will be hu

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"When I travel the world and say I work with UTC, people ask, 'What does it do?'"

by lower commercial aircraft sales, but the one-two punch of dumping a sagging unit for one that's dominant pleases David: "The [September 11] shock would have been twice as significant to us in 1990 as it is today."

Still, he seems piqued that investors have apparently failed to credit UTC for ongoing changes at its troubled Pratt & Whitney engine unit, which accounts for 36% of operating income. Once the standard for large aircraft, Pratt & Whitney now garners only 5.4% of new big-engine orders, excluding joint-venture projects, and is a distant No. 3 behind GE and Britain's Rolls-Royce. Pratt made the dubious decision two decades ago to not make an engine for the Boeing 737, the world's most popular plane. Pratt has also been unable or unwilling to compete on price in the cutthroat battles in the large-jet-engine business over the past decade. With its big engine deals withering, UTC increasingly has focused on more lucrative service contracts, small-engine sales, and even power generation. So while revenues have declined in recent years, margins have expanded. More military sales, such as the engine contract for Lockheed's new F-22 fighter, should also help offset falling commercial orders.

Now service business is falling off, as airlines ground their older jets first. But David's obsession with quality and cost-cutting—as well as 5,000 recently announced layoffs at Pratt and Hamilton Sundstrand—are helping to keep those units profitable. Pratt President Louis Chênevert feels like he "talks to the Street all the time," and investors still don't get that Pratt is half as reliant on big commercial engines as it once was. Yet some critics insist that investors know exactly what they're doing. Says Paul Nisbet, an aerospace analyst with JSA Research Inc., "They've been losing market share in a critical area, and now they face a sudden drop in their aftermarket business."

Even so, David's challenges with Pratt can't compete with his frustration over Carrier Corp. On Oct. 11, he replaced Jonathan W. Ayers, president of the air-conditioning unit, with Geraud

Darnis, previously president of UTC's power group. The move was officially dubbed a resignation, but it's no secret that David was unhappy with Carrier. Although its operating margins in the past five years rose to 9.4% from 7.1%, those at the rest of UTC showed far better improvement, climbing to 15.6% from 9.5%. "Carrier is a drag, and we don't like drags," snaps David. The refrigeration business in particular has been hurt as it has tried to integrate a spate of small acquisitions during the economic downturn. Sure, it's cyclical, but that's no excuse, says

ness during the war. Sikorsky has already joined with Boeing to create the Army's RAH-66 Comanche helicopter.

David already knew before September 11 that UTC needed more heft to really thrive. He's still almost wistful at the failure of his biggest attempt at makeover, the merger with Honeywell. That would have doubled UTC's revenue and added a slew of new aerospace businesses. "We would have more financial muscle and reach at twice our size," says David. Although European regulators nixed GE's merger as well, Honeywell's management now says it isn't interested in partnering with anyone. While David wants to make more deals, he says that now is not the time to use volatile stock or deplete cash. He warms cash on hand in case his troubled airline customers need more flexible financing.

STOCK SPLIT? Changing UTC's image or lack of one—will also be an important part of convincing investors that UTC prospects are sound, say insiders. It doesn't help that UTC's name doesn't appear on any of its products, unlike rival GE. As Otis President Steve Pappas says, "when I travel the world and say I work with UTC, people ask, 'What does it do?'" So when London ad agency Euro RSCG Wnek Gosper began to develop new ads for UTC two years ago, it found it had to compensate for a corporate culture awash in modesty. To justify things up, one ad shows UTC scientists in dark suits and sunglasses with the slogan "The Punks Who Killed Heavy Metal." In other words, UTC is on the cutting edge of technology.

Now if David can just convince Wall Street. Already the stock has rebounded to around \$53 from its post-attack low of \$41.64 on Sept. 20. David could even push for a stock split, says UTC director Sanford I. Weill of Citigroup. Weill calls David one of the best managers he's ever met, and one of the most private: "Even his hobbies aren't the kinds of things where there are a lot of people." That includes sailing world-class yachts and collecting rare books. When it comes to UTC, though, David is determined to start drawing a crowd.

By Diane Brady
in Hartford

The punks who killed heavy metal.



UTC is a leading provider of...
UTC is a leading provider of...
UTC is a leading provider of...

David: "Our instinct is fix it or drop dead." That means squeezing out more productivity gains and developing new markets.

That strategy has worked for UTC's other main businesses. Take Otis Elevator Co.: Its prospects are linked to construction markets, but 72% of its revenue flows from service contracts and upgrades. It also benefits from a diverse geographic base, operating in more than 200 countries. And Sikorsky, which makes the Black Hawk and Sea Hawk helicopters, should get more busi-

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scientists
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shades for
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TELECOMMUNICATIONS

IS BELL SOUTH JUST WINDOW SHOPPING?

Some of its execs want a merger with AT&T, some with Sprint. Another big camp wants to stay solo

As a winning collegiate tennis player, F. Duane Ackerman waited patiently before rushing the net. Longtime friends say the future chairman of BellSouth preferred to rally from the baseline, concealing his own game while tirelessly wearing down his opponent. Only when opponents faltered, revealing a weak backhand or wobbly serve, did Ackerman move in for the kill. In business, as in tennis, the 59-year-old Ackerman has largely kept BellSouth on the baseline. He has focused on the

company's traditional voice business in the Southeast while his competitors chased after mega-mergers and invested billions in hot new digital technologies.

Now Ackerman is eyeing the net. In recent months, BellSouth's chief executive has held preliminary merger talks with AT&T, Sprint, and upstart Williams Communications Group, according to former BellSouth executives and two BellSouth insiders. The sources say the Williams deal is

dead because the company is too small to add much to the local phone giant, and a deal for AT&T or Sprint won't happen until next year, if at all. Still, Ackerman is seriously considering a blockbuster merger that could remake BellSouth from the stodgiest of the Bells into an industry

MOTIVATED
Declining revenue growth is putting pressure on CEO Ackerman to increase his company's heft

powerhouse. "BellSouth needs to do something," says Mark Herskovitz, senior sector manager for telecom investments at Dreyfus Corp., which owns 1.2 million shares of BellSouth. "It's just too small

While going it alone has worked reasonably well so far for Ackerman, the solo path is becoming increasingly difficult. When BellSouth reported third-quarter earnings on Oct. 18, it revealed growing troubles in its business. The number of phone lines in its region, the key indicator of a local phone company's health, dropped 1.4% over the past year to 25.6 million, as rivals swiped corporate customers and consumers disconnected second telephone lines. As a result, revenue from core telephone operations grew only 4.6% to \$4.7 billion, slowing considerably from last year's double-digit growth rate.

DISSENTION? With the pressure on, tensions are rising at BellSouth. While Ackerman and other top execs declined to comment publicly, *BusinessWeek* has pieced together a behind-the-scenes look through interviews with current and former executives, competitors, and consultants. They say discussions about merger possibilities have split BellSouth's top execs into three camps. One favors a deal with AT&T, another with Sprint. The third and largest would rather see the company remain independent for the foreseeable future.

The debate has strained BellSouth's genteel corporate culture. Typically, BellSouth, top execs avoid direct confrontations, letting their subordinates hash out big issues in small informal meetings. At a recent meeting, chief strategist Keith O. Cowan criticized arguments to buy Sprint, according to one person who attended the meeting. Ackerman listened politely to Cowan's critique—then froze him out of the rest of the discussion. So did the 10 or so other executives in the room. "They just ignored him, as if he'd never spoken," says the source. "It was like Cowan had been quiet, tarred and feathered."

Cowan declined to comment.

Cowan leads a small, outspoken camp that favors a deal with AT&T, insiders say. He wants BellSouth to become a global player and sees AT&T as the best way to make that happen, former execs and outside observers say. With AT&

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Because a good plan is a terrible thing to waste.

BellSouth's revenue would nearly triple to \$83 billion, more than any other U.S. telecom player.

The biggest strategic boost would come in serving corporate clients. BellSouth is weak in this market: Less than 10% of its revenue comes from sales to businesses, and it has lost 24% of its business customers to rivals, largely in the past five years. AT&T's business division, with strong offerings in high-speed Net access and Web-site hosting, could help BellSouth stem the loss of existing customers. And once BellSouth wins approval to offer long distance within its region—which is expected to begin early next year—it will have a fresh opportunity to cross-sell AT&T's voice and data services to major companies in the Southeast. That could help boost growth in AT&T's \$28 billion business division, where revenues are expected to rise less than 1% this year.

LEADING CONTENDER. The talks with AT&T are the most serious of the merger discussions. They started about two months ago and are now on the back burner while AT&T concentrates on talks to sell its cable-TV business to Comcast

OPPOSED The faction that wants to remain independent is bolstered by a report saying a merger with AT&T or Sprint wouldn't help the bottom line right now

Corp., sources inside AT&T and BellSouth say. The talks are expected to resume by January, after the cable deal is done.

A second camp within BellSouth fears AT&T is more swamp than solid ground. To them, AT&T, with its endless management turmoil, would be impossible to meld into the Atlanta-based Bell, with its collegial culture. They also fear the troubles of AT&T's residential long-distance business, where revenues are expected to plunge 20% this year.

This group favors buying Sprint, the country's third-largest long-distance player. The idea was considered as far back as 1999 and championed by C. Sidney Boren, the former head of strategic planning. Today, the group includes David W. Scobey Jr., president of small business services, among others, say in-

siders. A Sprint deal would boost BellSouth's revenues to \$53 billion from \$2 billion. More importantly, it would give BellSouth access to Sprint's Internet backbone, the second-largest in the world after WorldCom's. It would give BellSouth entry into the market for corporate services, albeit on a much smaller scale than AT&T. And Sprint's local phone unit, serving 8 million rural and suburban customers in Texas, Missouri and 16 other states, would fit nicely with BellSouth's local-phone business and generates about \$3 billion a year in cash. The Sprint camp at BellSouth would pass on wireless player Sprint PCS Group, which is smaller than the Cingular wireless venture operated by BellSouth and SBC, one consultant says.

Many BellSouth executives still believe the company should remain independent. Led by Chief Financial Officer Ronald M. Dykes, this camp argues that there's nothing wrong with a company that is posting slow, dependable growth, especially when so many ambitious players are imploding. Indeed, Merrill Lynch & Co. forecasts that BellSouth's revenues will grow about 7% annually through 2004 and net income will increase about 8% yearly. The Dykes camp has been bolstered by a recent internal report prepared by Deloitte Consulting that concluded that the addition of AT&T or Sprint would add little to BellSouth's bottom line until it has regulatory approval to provide long-distance service. "It's hard to make an argument now for BellSouth buying either AT&T or Sprint," says telecom analyst Adam Quinton of Merrill Lynch.

Only Ackerman has the power to break the management logjam within BellSouth, consultants and company executives say. If he does any deal, Ackerman is said to prefer one with AT&T, one person close to the talks says. For all of its problems, AT&T still has the most powerful brand in telecom. At one AT&T source says Ackerman would take some satisfaction in buying BellSouth's former corporate parent and reuniting two pieces of the old Bell System. To accomplish something historic, Ackerman will have to get aggressive and rush the net.

By Charles Huddad in Atlanta

WEIGHING THE ALTERNATIVES

BellSouth is contemplating its biggest move ever. Merger talks with both AT&T and Sprint have been held in recent weeks. Here's how the options stack up:

	PROS	CONS
BUY AT&T	AT&T is a top brand. It has global voice and data networks, and it's a key provider of communications to multinational corporations and governments. After AT&T sells off its cable business, the phone business could cost \$30 billion to \$40 billion, say analysts.	AT&T's consumer long-distance business is sinking. Its market share dropped to 42% this year, from more than 50% in 2000, and the division's revenues are expected to shrink by nearly 20% this year, to about \$15 billion in 2001. The business also is loaded with \$39.5 billion in debt.
BUY SPRINT	Sprint has a nationwide network and strong Internet services that would help BellSouth serve large corporate customers. It also has a small, profitable local phone business that would fit nicely with BellSouth. Sprint could go for \$20 billion to \$25 billion, a relative bargain, say analysts.	Sprint's growth is slowing in every market except wireless. In October, it shut down its high-speed corporate Internet service, ION. A merger would leave the combined company much smaller than local phone rivals Verizon and SBC in revenues and in market cap.
DO NOTHING	BellSouth's nine-state local phone business posts single-digit growth. Its nationwide wireless partnership with SBC, known as Cingular, is a success. With those businesses, BellSouth probably can survive as an independent—and profitable—company.	BellSouth's main voice and data businesses are slowing, with the exception of wireless. If it doesn't do a deal, it will become a slow-growing, smaller player. That will make it difficult for the stock to continue to outperform the industry.

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John D. Anderson, FAIA
2001 President

On September 11, terror breached all barriers and borders, striking at our people and our principles. We grieve for the victims and and those they leave.

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Senator Moynihan was right. Even in our sadness and uncertainty, fear cannot become the architect of our democracy.

A handwritten signature in dark ink, appearing to read "John D. Anderson".

President, The American Institute of Architects

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ALTIMA vs.
CAMRY,
VCRs THAT ZAP
COMMERCIALS

BusinessWeek Lifestyle

The Mighty Camry Has Competition

Nissan's redesigned Altima stands up well to Toyota's best-seller

BY LARRY ARMSTRONG

Every throne has its great pretender, and cars are no exception. Right now, it's the all-new, bigger-and-better 2002 Altima, the first car Nissan has fielded in more than a decade designed to go head-to-head with Toyota's Camry, the best-selling car in America for the past four years. This Altima's a beaut, and it will make Nissan a strong contender in the huge and lucrative market for midsize family sedans. Toyota isn't ready to hand over the title, however. Its new fifth-generation Camry is an ever-more-refined version of its predecessors and should help Toyota fend off all comers, including the popular Honda Accord and Ford Taurus, for the foreseeable future.

I've been driving the new Altima and Camry for the past few weeks. I found a lot to like about both of them and jotted down a few quibbles as well. But while they're aimed at the same audience—the young family with a couple of kids at home—they are very different vehicles.

EYE CANDY. Take the Altima. Unlike most cars in this category, where the styling can be generously described as bland, the Altima is noticeably stylish, even elegant. The nose dives down in front, and the roofline traces a long, sloping arch, ending in a short, high rear deck. You see this profile more on sporty coupes than sedans. In silhouette, it resembles Toyota's Lexus GS luxury sedans.

That's not all that says sport/luxe about the Altima. It has big, 16-inch tires—17-inch on the V6 model—pushed out to the corners of the car. That's for better handling, but it also gives the Altima a more confident stance. Dual exhausts, with cutouts in the bumper to accommodate them on the V6, are more often found on performance cars. And the headlights and taillights are mounted in gorgeous jewel-like clusters of large, round lamps covered by clear glass.

All this for a price that starts at \$18,539 for the nicely outfitted Altima 2.5 S four-cylinder

model. There's a base car at \$16,889, but you can't get it with air conditioning. The V6 version, a first for Altimas, starts at \$22,889.

The interior of the Altima was a bit busy for my taste, with its two-tone trim (three if you opt for the cheap-looking wood-tone inserts—don't) and a sculpted plastic panel that starts at the windshield and ends in an oval for the audio and air conditioning controls. That said, all the controls are high on the console and easy to use. The instrument panel, with three

NISSAN ALTIMA

ALTIMA 2.5 S
2.5-liter, 175 hp
4-cylinder engine
\$18,539

ALTIMA 3.5 SE
3.5-liter, 240 hp
V6 engine
\$22,889 to \$29,310



deep pods backlit in orange, is the cabin's best feature.

The car is slightly bigger than the Cam and Accord and dramatically bigger than previous Altimas—some 2 inches taller and 7 inches longer between the front and back wheels. That translates into big doors, making it easier to get in and out of the back seat, and plenty of rear legroom for grownups.

Where the Altima really shines, though, is in the luxury amenities not normally found in a car of this class. Things I missed when I traded in a mid-line four-cylinder Altima for the top-of-the-line Camry I drove the next week: A handbrake in the center console instead of a pedal under the dash, a steering wheel that telescopes as well as tilts, a trunk release on the door instead of the floor and headlights that come on automatically at night.

Autos

The Altima has all the advanced safety features, though none is standard equipment. Anti-lock brakes and side air bags, including a side curtain at head level, are available as a package all but the base model for \$749. Traction control, useful on gravel or slippery roads, is a \$99 option, but can be had only on the V6 models.

On the road, you'll never mistake the Altima for a sports car. But it has a nice,ppy 175-horsepower engine and a suspension that absorbs most of the bumps and lets you take corners without the queasy feeling that you're about to lose control. If you want raw power, go for the class-leading V6 with 200 hp. Nissan figures about 80% of its buyers will; I don't think it's necessary, but, hey, it's your budget.

While the Altima is angling for a road-hugging, crisp-handling, dare I say, fun-to-drive experience, the Toyota Camry is basic transportation. But this is basic transportation refined to the nth degree. It starts when you slide behind the wheel and turn the key. Did the engine actually start? You can barely hear it. Motoring along, the car deftly sops up all the flaws in the roadway,

father's Lincoln, but edging uncomfortably close.

Still, it's hard to criticize the Camry. The interior is near-perfect, with a high-mounted, smallish dashboard—no vast expanses of plastic here. The instrument cluster is a simple affair that tells you all you need to know at a glance. My first impression was that it was a bit cheap-looking with its white characters on black for most models. But when night fell and the backlights came on, I changed my mind. The instruments are simply understated, like almost everything else about the Camry.

EERILY QUIET. You get little feedback from the road in the car: The steering is on the light side. But that's O.K. with Camry owners—they're more interested in the ride. It's smooth and stable—and almost eerily quiet. Side air bags and

curtains are a \$500 option.

On the step-up models, you can get a touch-screen display, high in the center of the dash, that serves as both the audio controls and a global-position navigation system. The screen tilts down at a touch of a button to reveal slots for playing compact disks and cassettes. It's an extra \$1,830 on the XLE models.

Feature for feature, the new Camrys are less expensive than last year's. But Toyota has dropped the previous low-end model entirely, which puts the price of entry at \$19,455, a new high.

Altima offers useful amenities not found on the pricier Camry, including a telescoping steering wheel and headlights that go on automatically at night

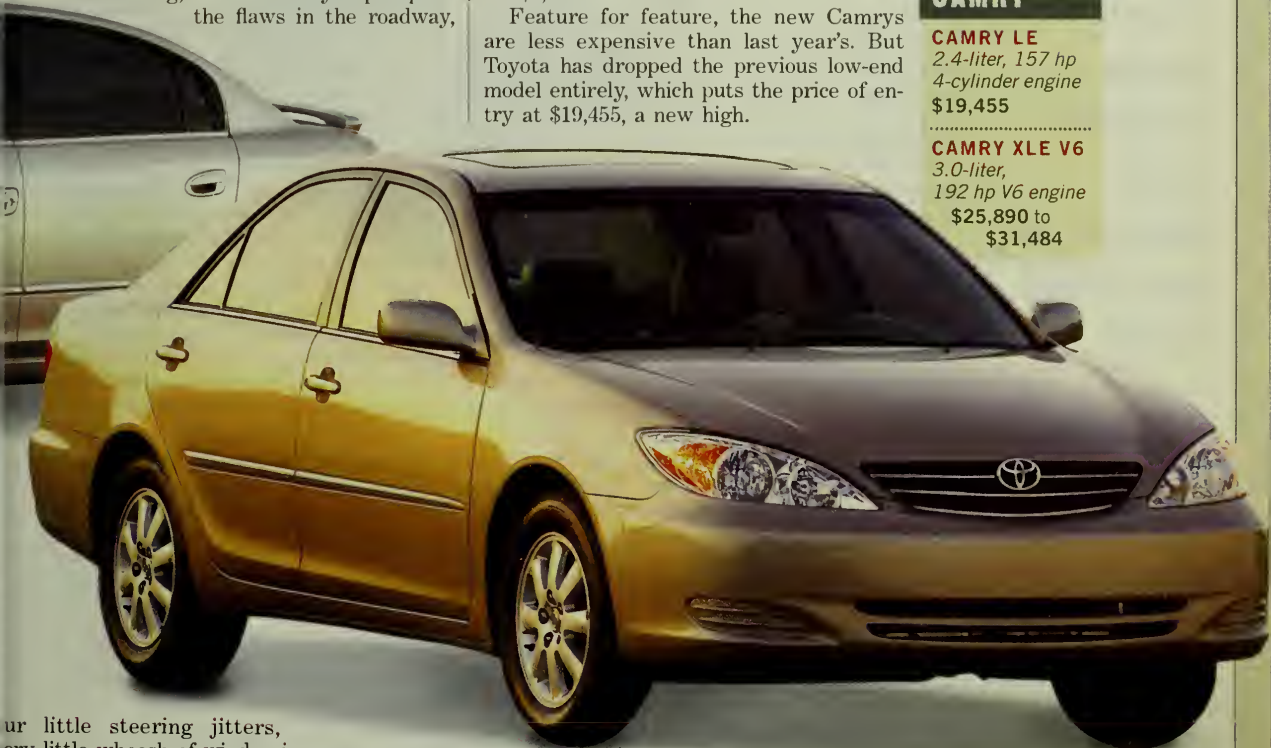


GLOBAL POSITIONING: Camry has it as an option; Altima doesn't

TOYOTA CAMRY

CAMRY LE
2.4-liter, 157 hp
4-cylinder engine
\$19,455

CAMRY XLE V6
3.0-liter,
192 hp V6 engine
\$25,890 to
\$31,484



ur little steering jitters, every little whoosh of wind noise. From the outside, Toyota has sharpened the edges, but there's still no mistaking this car for anything other than a Camry. Dual creases on the hood lead into a new, bolder grille. There are more chiseled edges, and a new line sweeps the sides from front to rear. The back end now has the barest hint of a lip, but it also has picked up the same pretentious chrome bar as Toyota's flagship Avalon model. Not quite your

Still, 423,000 Americans (last year alone) can't be wrong. And a quarter of them traded up from another Camry. There's a huge audience for a no-apologies, holds-its-value kind of car, and Toyota isn't about to make any abrupt changes that might jeopardize that. Meanwhile, the folks at Nissan, justifiably proud of their effort, will be ecstatic if their brand-spanking-new Altima sells half as well.

Look, Ma, No Ads

Zap them with a two-tape VCR

BY
LARRY ARMSTRONG

Go-Video scans
and marks
the ads in
TV broadcasts
and then
speeds past them
when it recopies
the tape

I've always been against the idea of dual-deck VCRs. They're bulky, taking up a lot of valuable real estate next to your TV. And they've never been able to do anything you couldn't do on your own by hooking together two, much-cheaper, solo VCRs.

Until now. SONICblue's latest line of Go-Video dual-deck VCRs includes a killer new feature that makes the concept mighty attractive—and definitely worth the \$50-or-so premium for buying two VCRs in one. It's called Commercial Advance.

The technology, which marks the ads in TV shows and fast-forwards through them on playback, has been used by VCR makers in the past. The Go-Video machines take the next logical step. After they record your show, they automatically copy the first tape to a second one, eliminating the commercials.

LESS MESS. I've been playing around with the mid-line, \$250, DDV2110 model for a few weeks. I had some concerns as I wedged it in among the other black boxes in my system. For one thing, it's huge. Picture two VCRs side-by-side, and you'll get an idea how big it is. But my big concerns were whether it could zap all the commercials and how badly picture quality would suffer.

Yowza! It worked as advertised. I recorded six shows, ranging from half-hour sitcoms to two-hour-plus movies. By and large, it got rid of 99% of the clutter—and all of it in shows of an hour or less. It's easy to dispatch what remains with the fast-forward button. (You can fast-forward through the ads in any videotape, of course. But, if you're like me, you're fumbling around with the remote control so much that you usually miss the exact instant the show returns.)

Commercial Advance

PLUG 'N' PLAY: Setting up the Go-Video machine is a snap

works by scanning a recorded tape and looking at the black levels between the broadcast segments, such as when the picture fades to black just before an ad, and for the 15-, 30-, and 60-second time patterns of typical TV ads. It then

makes an educated guess as to which segments have got to go **FUZZIER.** With the Go-Video dual VCR, you insert two tapes and program the VCR to record a TV show. After the recording is finished, the tape rewinds and the deck starts scanning for commercials. It takes about 15 minutes to identify and mark the ads in an hour worth of programming. Then, the tape rewinds again, and the machine copies the program to the second tape. When the first deck fast-forwards through a commercial, the second deck pauses so the ad isn't copied. Because the commercial-skip feature more than dou-

bles the time it takes to record a show, you're better off using it to capture programs that are when you're gone or in the middle of the night.

Most of its guesses about commercials are right on. It doesn't look at the first or last two minutes of a recording, and it misses any commercials longer than a minute. In my case, all the instances where it failed to spot a commercial came in movies I was taping from cable channels such as TNT, Lifetime, or USA Network. Those channels often run two-minute ads or commercial breaks that run longer than four or five minutes. Either will defeat the system.

All dual-deck VCRs offer other advantages. For the many people who confess to having problems programming a single VCR, wiring two together is a bit much to ask. It was a snap to hook up the Go-Video machine, without the rat's nest of cables I need to hook two machines together when I'm trying to copy a tape, say. And with Go-Video, copying a tape is a one-button affair: You don't need to choose the inputs and outputs, and press the "Play" button on one and the "Record" button on the other.

A word about picture quality: Yes, the finished product looks like a copy of a copy, with slightly fuzzier edges and that typical color smearing you see in homemade videotape. However, there's a trade-off here. To me, the picture is acceptable, and all the more so because I can watch it uninterrupted, free of commercials.





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Ford Quality Checked

www.fordcpo.com

GartnerG2

www.gartnerG2.com

Hewitt Associates

www.hewitt.com/decision

Hewlett Packard

www.hp.com

IBM

www.ibm.com/e-business
www.ibm.com/services/strategy

LeadersOnline

www.leadersonline.com

Lexus Certified Pre-Owned

www.lexuscpo.com

NEC/Mitsubishi

www.necflat.com/bizweek

Oracle

www.oracle.com

Pioneer North America

www.pioneerelectronics.com

Prudential Financial

www.prudential.com

PTC

www.ptc.com

Rational Software

www.rational.com

Samsung Electronics Co. Ltd.

www.samsung.com

Samsung Group

www.samsung.com

Sharp Electronics Corporation

www.sharp-usa.com

Siebel Systems

www.siebel.com/

Sun Microsystems

www.sun.com

Symbol Technologies

www.symbol.com

The United States Postal Service

www.usps.com

Toyota Motor Sales

www.toyota.com

Xerox Document Centre

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BusinessWeek Investor

Unlocking The Door To Closed Funds

*Here are several
ways to get in*

BY LEWIS BRAHAM

Musciez is desperate to buy Schroder Ultra Fund: "For anyone interested in making some extra cash, I am willing to

pay 10 times the current value for one share," an investor with that screen name recently posted on the fund's bulletin board at Morningstar.com. That would be \$440 a share for a fund currently priced at \$44. The offer doesn't deter dewsdad84, who bids \$1,000 for one share. Another poster, dotkos, thinks \$10,000 is a fair price.

All three are searching for a door into a red-hot mutual fund that stopped accepting new investors in December, 1998. Since Schroder Ultra's three-year annualized return, 107.0%, is the best in the entire 6,000 mutual-fund universe, these investors are willing to pay an enormous premium for just one share. Once they get this toehold into the fund, they can buy as many shares as they like at net asset value.

GO TO THE SOURCE. As the jockeying for Schroder Ultra shows, the Internet has given rise to a gray market in shares of closed funds. While such transactions are legal, you should use them only as a last resort. Indeed, many closed funds aren't worth the trouble. "A fund closing is often a sign that too much money is coming in at once, and the manager is having trouble investing it," says Mark Gleason, a Glendale (Calif.) financial planner. For every Schroder Ultra, there's a \$14 billion Janus Twenty, down 47.4% in the past year.

If you feel you must gain entry into a closed



fund, you should first call the fund company sales reps and ask if they know of anyone selling shares you can buy or if you can at least put your name on a waiting list to get in. You have a good shot at picking up shares if the fund manager wants to avoid selling stock positions to pay off redemptions or if you have a significant amount of money to invest and can convince the manager you will hold the fund for the long term.

If you have no luck with the fund company, ask friends and relatives if they hold the fund and would be willing to sell you a share at the

current price. All they would have to do is fill out a form called a Letter of Instruction (LOI) or Letter of Authorization

(LOA) and send it to a mutual-fund broker or the fund company. The document authorizes the transfer of the share to your investment account. Once the share is delivered, you should have the same right to make additional investments as do the long-time shareholders.

Some fund companies erect obstacles to such backdoor deals. Janus doesn't let investors keep transferred shares of a closed fund, requiring them to be exchanged for shares in one of Janus' open funds or for cash. Oakmark Funds will accept low transfers only in its closed Oakmark Select fund of shares worth at least \$1,000, the fund's minimum initial investment. Caldwell & Orle-

Mutual Funds

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Michael G. Carey, President

First, make sure the fund you're interested in will return the premium it costs to obtain shares. Many closed funds aren't worth the trouble

Market Opportunity Fund permits one-share transfers but requires the buyer to increase the investment to \$100,000 within 60 days or the fund company will liquidate the account. Schroder forbids transfers of its Ultra fund altogether.

Yet even these walls can be surmounted. By transferring shares through a mutual-fund supermarket such as Charles Schwab, the transaction becomes invisible to the fund company. That's because fund supermarkets pool the assets of every client invested in a particular fund into a single "omnibus account." That saves fund companies a fortune in record-keeping expenses but makes it impossible for them to track individual trades. "At the end of the day, each fund is getting only one buy order and one sell order from us," says Greg Gable, a Schwab spokesperson. Supermarkets can enforce restrictions, but with thousands of different funds under one roof, closed-fund transfers are hard to police.

ACCESS FOR A FEE. You can also get into a closed fund through a financial planner who holds its shares. When you become a client, your assets become part of that planner's omnibus account. So he or she can buy shares of the fund for you. I found several planners with access to top-ranked closed funds by e-mailing the National Association of Personal Financial Advisors at info@napfa.org. But that makes sense only if you need a financial planner and are willing to pay the fees.

If you have no recourse but to try the gray market, you can post your offering price on bulletin boards designated for each mutual fund

The Best of Closed Mutual Funds

FUND/SYMBOL	TYPE	3-YR. RETURN*	ASSETS MILLIONS
AIM SMALL CAP OPPORTUNITIES ASCOX	Hedged	35.0%	\$256
BJURMAN MICRO-CAP GROWTH BMCFX	Micro-cap	45.7	270
BRAZOS MICRO CAP BJMIX	Micro-cap	33.3	228
BRIDGEWAY MICRO-CAP LIMITED BRMCX	Micro-cap	38.6	48
CALDWELL & ORKIN MARKET OPP. COAGX	Hedged	6.9	251
FRANKLIN BIOTECH DISCOVERY FBDIX	Biotech	34.8	805
FRANKLIN U.S. LONG-SHORT FUSLX	Hedged	NA	284
HARTFORD MIDCAP HFMCX	Mid-cap	25.2	1,412
SCHRODER ULTRA SMCFX	Micro-cap	107.0	149
T. ROWE PRICE INTL DISCOVERY PRIDX	Foreign	20.6	555
TURNER MICRO CAP GROWTH TMCXG	Micro-cap	62.1	160
WASATCH MICRO CAP WMICX	Micro-cap	40.2	324

*Annualized total return as of Oct. 22, 2001, including appreciation plus reinvestment of dividends and capital gains before taxes

NA = Not applicable

Data: Morningstar Inc.

that is tracked by Morningstar.com. Interested shareholders will then contact you privately cut a deal.

But first, make sure the mutual fund you are worth a premium. The best-performing closed funds are small or unique. Caldwell & Orkin Market Opportunity is a long-short fund that has much lower expenses than the average hedge fund and a five-year annualized return of 14.4%. Schroder Ultra, Turner Micro Cap Growth, Bridgeway Micro-Cap Limited, and Wasatch Micro Cap are all small-cap funds whose tiny asset bases have enabled them to beat 96% of the peers for the past three years. Getting access to that kind of performance may make the steep cost of entry worthwhile.



Suddenly, Everyone's Looking for Life Insurance

To get the best deal on term coverage, you'll have to shop around

BY PALLAVI GOGOI

If recent headlines have you wondering whether you have enough life insurance to provide for your loved ones in case of your untimely death, you're not alone. Insurance agents have reported a sharp increase in inquiries, especially among those in their 30s and 40s, a demographic group that has generally been nonchalant about insurance. "Everyone's mortality flashed right before their eyes on September 11," says Robert Hartwig, chief economist of the Insurance Information Institute.

Many professionals rely on group term-life coverage provided by their employers. Term insurance, which is the simplest and least expensive kind, pays a set amount to your beneficiary if you die in the period covered by the policy. But while free, company-provided coverage may increase with your salary, it often isn't enough and supplemental insurance through employer group policies, although convenient to purchase, may not be the most economical way to go. The good news is that individual term-life policies have gotten cheaper and easier to buy, thanks



increased competition and the Internet.

Before you begin shopping for term-life insurance, evaluate how much you need. If you're healthy, unmarried, and without dependents, you can probably forgo life insurance and stick to buying disability coverage. But if you have dependents, the rule of thumb is you need to be covered for five to seven times your annual income. Of course, a lot depends on how much you have socked away in investments, retirement plans, and college savings plans as well as the size of your estate and debt. All this can quickly get complex, and you may want to check with a financial planner. But, as a first step, you can evaluate your needs using online calculators offered by insurers or at independent sites. For an especially easy one to use, check www.life-line.org (table).

SALES PITCH. With an idea of how much coverage to go for, you can sort through your options. Going with your company's group policy may be tempting: You can usually increase the amount without having to qualify for a new policy. But the premiums rise every year, and your costs are assessed as part of a pool that includes smokers and people with various illnesses. As a result, you'll likely get charged more than if you buy as an individual from an independent insurance provider. This is particularly true if you're young, healthy, and female. (Women tend to live longer than men, so their rates are lower).

Free employer-provided life insur-

ance isn't entirely free because employers pay an imputed tax, deducted from the paycheck, on any amount over \$50,000. The tax per \$1,000 of coverage per month runs from 5¢ to \$2.06, depending on your age. One other hitch: The coverage may not be portable; leave your job, and you usually leave your insurance behind. When policies can be converted, costs are high and terms aren't favorable. But there are times when a supplemental group life policy may be a good idea—say, you have an illness, or fly planes as a hobby. In these cases, the coverage actually may be cheaper, and some companies let you add to your coverage up to a set level without a medical exam.

Barring such circumstances, the best way to get adequate insurance is to take the free policy your company offers—which probably covers one to two times your annual salary—and then shop around for individual term life insurance. Sites such as www.quickquote.com, quotesmith.com, or masterquote.com are good pricing sources. But online rates aren't guaranteed; they could change depending on your medical exam results.

You do have the choice of completing the transaction online (with final approval depending on your medical exam) or going to an insurance agent for the final purchase. The latter route won't add to your costs, but you may have to endure sales pitches for costlier coverage, such as cash-value insurance, which combines term-life with an investment account.

We tried out the sites to find how much a healthy, 45-year-old, nonsmoking male would have to pay for term-life coverage. Ideally, he should have \$1 million in coverage for 15 years if he has a working spouse, two young children, and an annual income of between \$150,000 and \$200,000. Masterquote.com turned up the cheapest price from an A+ rated company: \$88 a month, or \$1,050 a year for 15 years; from Protective Life & Annuity Insurance. Guardian Life, in contrast, charges \$158 a month, or \$1,900 a year.

It's crucial that the insurer you pick has a high rating for financial stability from such rating agencies as Standard & Poor's, A.M. Best, Duff & Phelps, Moody's, and Weiss Group. Consider only insurers with ratings of A+ or higher, says Veeva Kutler, a financial analyst at Chase (Md.)-based Mosaic Investment Solutions. After you have the policy, continue to check your insurer's rating annually with at least two agencies. If its rating declines, you may want to consider switching. It pays to cover all the bases.

Tools for Shoppers

CALCULATORS (WWW.)

ficgroup.com

life-line.org

lifenet.com

underwriter.com

QUOTES (WWW.)

accuquote.com

consumerquote.com

4termlifeinsurance.com

instantquote.com

insure.com

masterquote.com

quickquote.com

quotesmith.com

selectquote.com

BusinessWeek online

WOMEN AND MONEY: For a special report on financial lessons from the World Trade Center disaster, go to the Oct. 24 Daily Briefing at www.businessweek.com



IRIDIUM

Our hearts go out to the families of all victims.

DID TYCO DEEP-SIX TYCOM INVESTORS?



BY ROBERT BARKER

rb@businessweek.com

Fifteen months ago, Tyco sold 14% of TyCom, its undersea-cable unit, to the public at \$32 a share. Now, it's buying the stock back—for \$15.42

What would you call me if I sold you something for \$32 and later took it back for \$15—even as I suggested it will be worth much more soon? Once you stopped cursing, you might call me opportunistic, sly, or just plain smart.

All those adjectives fit Dennis Kozlowski, CEO of Tyco International. Deal by deal, Kozlowski has built Tyco into a \$36 billion conglomerate that proved itself swift, profitable, and rewarding enough to shareholders to take first place in this year's BusinessWeek 50, our annual ranking of corporate performance. Yet look at what Kozlowski is up to with TyCom, Tyco's unit that builds and services undersea telecom cables. If you're an investor in TyCom, you'll want to throw in the curse words, too.

Here's what I mean. In July, 2000, Tyco raised \$2.1 billion by selling 14% of TyCom in an initial public offering led by Goldman Sachs. The telecom biz had not yet begun sinking to its current suboceanic depths, so the stock sold well. From an IPO price of \$32, it topped \$46 in a few weeks (chart) on hope for sales of bandwidth on the global fiber-optic network TyCom is building.

SUSPICIOUS. That was as good as it got for TyCom's minority shareholders. By March, with telecom shares tanking, the stock dipped below \$10. After the terrorist attacks, TyCom nearly hit \$7. That's when Kozlowski struck. On Oct. 4, Tyco bid to buy out TyCom's public shareholders for \$14 in Tyco stock. Two weeks later, after haggling for a bit more stock, TyCom's three independent directors agreed to the deal, now valued at \$15.42 per share.

What's wrong here? First, it's impossible to ignore the suspicious price and volume action in TyCom shares before the bid was announced (chart). On Oct. 3, the day before Tyco made its bid, TyCom shares jumped 22% on higher volume, even as the broad market rose just 2%. The New York Stock Exchange's surveillance unit would not say whether it suspects illegal insider trading. A Tyco spokeswoman told me the company will cooperate in any investigation.

Dismaying as that fishy trading may be, the buyout smells bad on its own terms. TyCom in the June quarter repurchased one in five of its publicly held shares for \$218 million—an average of \$14.22 a share. That was in cash, not stock, at prices it deemed a bargain. And TyCom's inde-

pendent directors, who are supposed to look out for public investors' interests, negotiated just two weeks to get TyCom shareholders 4.5% more Tyco shares. That still makes the deal worth less than half the \$32 a share Tyco took at TyCom's IPO just 15 months ago. TyCom directors did not respond to my calls for comment.

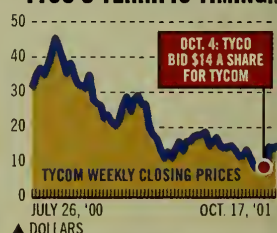
Given today's mess in telecom, isn't that enough? Not if you heard how Kozlowski described TyCom in a conference call with analysts the very day the independent directors signed off on the buyout. About telecom's woes Kozlowski said: "We see all of these issues temporary and expect the TyCom Global Network to generate excellent returns over time." He added: "We remain very optimistic about the future.... We are the last man standing."

He will likely prove right. One TyCom rival, 360networks, is now in bankruptcy, and another, Global Crossing, is weighed down by \$6 billion debt and is profitless. TyCom's debt comes to \$653 million, nearly all of it owed to Tyco and n-

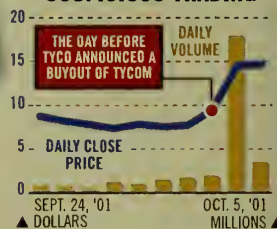
KOZLOWSKI:
ONE SLY
NEGOTIATOR



TYCO'S TERRIFIC TIMING...



...AND SOME
SUSPICIOUS TRADING



Data: Standard & Poor's Comstock

due before 2010. TyCom contributed a profit of \$415 million on revenue of \$1.9 billion to Tyco the fiscal year ended Sept. 30. Tyco expects similar performance in the current fiscal year.

Naturally, some shareholders are suing to block the deal, set to close in early 2002. Among other wrongs, they charge Tyco with cutting them out "to capture for itself TyCom's future potential without paying an adequate or fair price to the company's public shareholders." A spokeswoman told me Tyco never comments on pending litigation. How it will turn out, I don't know, but I'll be a favor: If you ever catch me negotiating opposite Dennis Kozlowski, call me dumb.

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Column

SEPTEMBER 11, 2001

*To the thousands whose lives have been lost,
your spirit has become our strength,
your sacrifice, our resolve,
and your peace, our hope for the future.*

Your memory will be with us always.

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ISUZU

SNIFFING OUT BOMBS



BY GENE G. MARCIAL

Sales of Thermo Electron detection gear may balloon. Net2Phone gets a big boost from Malone & Co. Avant's remedies could be adapted to fight anthrax

Looking for a big-cap company that makes money—and is also an anti-terrorism play? Stake out Thermo Electron (TMO), a maker of biomedical equipment, analytical instruments, and processing machinery for the paper and recycling industries.

Catching investors' attention in particular are its devices that sniff out explosives. The only sizable buyers of such gizmos prior to September 11 were Israel and Britain. In the U.S., the big airports had them, but funds were not forthcoming to equip every terminal. Now, all that has changed. Demand for the bomb detectors has shot up: Last year's sales of \$15 million are expected to balloon to \$75 million next year, figures Dennison Veru of Palisades Capital Management, which has snapped up Thermo, now at 21 a share. "We have a rolling target for the stock because of the terrorism factor," says Veru, who sees the price rising to 29 in a year.

If other anti-terrorism products from Thermo catch on, he says, the stock could shoot higher still. For example, its life sciences unit produces a detection kit for anthrax. The business is still quite small but, adds Veru, "it could grow rapidly with the war against bioterrorism." Management, he adds, is keeping silent about the details—as requested by Uncle Sam. Of Thermo's \$2.2 billion revenues, \$900 million comes from the unit that makes explosives-detection gear; \$800 million from life sciences, and \$500 million from the electro-optical unit, which makes laser systems. Veru thinks that, based on its current operations, Thermo should earn 90¢ a share in 2001 and \$1.07 in 2002.

JOHN MALONE'S NEXT CALL: NET2PHONE

What is John Malone up to now? Apparently, he isn't finished with AT&T—or rather, he isn't finished exploiting AT&T's missteps. He has formed a consortium to buy 49% of Net2Phone (NTP), a still unprofitable provider of Internet-based phone services. Net2Phone claims to be the first to connect Net phone users with the ordinary phone network, having routed more than 1.5 billion minutes of traffic over its Web network. "This is the new Malone obsession," observes one analyst. "Eventually he will end up owning Net2Phone."

Malone's group is composed of IDT, a long-distance company that spun off a big part of Net2Phone in July, 1999; AT&T, which bought 18.9 million shares (14.9

million from IDT and 4 million from Net2Phone itself) in 2000 at 75 apiece; and Liberty Media, headed by Malone, which recently bought Net2Phone shares from AT&T. An investor close to Liberty says Malone paid more than 5 a share. The stock has traded in the 3 to 4 range since mid-July. It closed at 4.30 on Oct. 24.

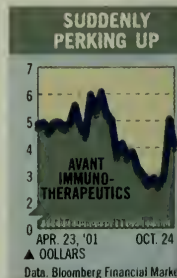
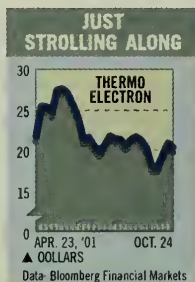
So why did Malone, who usually buys on the cheap, pay up this time? Malone believes Net2Phone is way undervalued, and he plans to boost its market cap, says a fund manager who bought in on Oct. 23, when the deal was announced. "How many times can you buy a stock for less than John Malone just did?" he asks.

Howard Jonas, IDT chairman, known as a close Malone ally, was named acting CEO of Net2Phone after CEO Howie Balter quit on Oct. 23. Jonas becomes chairman when Clifford Sobel leaves to become ambassador to the Netherlands. Net2Phone President Stephen Greenberg will then become CEO.

AVANT: SET TO MAKE AN ANTHRAX VACCINE

Now that the momentum players have bailed out of many anti-terrorism plays—taking their huge profits—the institutional investors are taking a serious look. One company that has caught their eye: Avant Immunotherapeutics (AVAN), whose stock spiked in early October when the anthrax scare began. Shares mounted from 2.71 on Sept. 17 to 5.15 on Oct. 12. Share price fell to 3.44 a week later but bounced back up to 4.30 on Oct. 23—after some large fund managers bought in. It has since eased to 4.04 on Oct. 24.

Causing the initial surge: A Defense Dept. contractor licensed its vaccine technology. It was assumed that the contractor, DynCorp, would use it to develop a vaccine against anthrax. Avant has developed oral vaccines against cholera and typhoid that have reached Phase II clinical trials. Its vaccines could be genetically engineered for use on anthrax by using the same technique that it uses on its anticholera vaccine, an Avant source says. An oral vaccine would be taken in a single dose "and acts very quickly," says Dr. Una Ryan, Avant's CEO. It has been tested on Army volunteers, with few or no harmful side effects, says one Avant insider. Mark Monane of investment firm Needham & Associates expects Avant to post sales of \$3.5 million in 2001 and \$4 million in 2002. He sees profits in 2003 of 26¢ a share, on sales of \$11.2 million.



BusinessWeek online

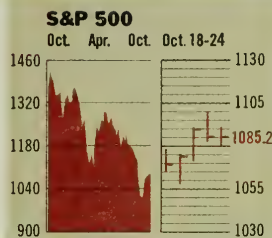
Read Gene Marcial's Inside Wall Street Online column Tuesdays afternoons at www.businessweek.com/today.htm. And see Fridays at 1:10 p.m. EST on CNN's *The Money Gang*.

We won't forget the victims, the families, the heroes.

The people of Texas Instruments worldwide join in expressing not only our grief,
but also our determination to move forward. We honor the memory
of those lost and the heroism of those leading in the recovery.
Our thoughts and sympathies reach out to the lives that were forever changed.



Stocks



COMMENTARY

Stocks rose, shrugging off a worrisome Federal Reserve survey of economic activity released on Oct. 24. The Fed's Beige Book showed a deepening slump as a result of the terrorist attacks. Investors, however, are betting on more interest-rate cuts and a recovery. For the week, the Dow Jones industrials, the S&P 500, and Nasdaq gained 1.2%, 0.8%, and 5.2%, respectively.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Oct. 24	Week	% change Year to date	Last 12 months
S&P 500	1085.2	0.8	-17.8	-22.4
Dow Jones Industrials	9345.6	1.2	-13.4	-10.1
Nasdaq Composite	1731.5	5.2	-29.9	-49.4
S&P MidCap 400	455.7	1.9	-11.8	-10.6
S&P SmallCap 600	202.9	0.8	-7.6	-2.7
Wilshire 5000	10,001.1	0.9	-17.9	-23.3

SECTORS

	Oct. 24	Week	% change Year to date	Last 12 months
BusinessWeek 50*	710.9	-1.3	-26.7	-36.6
BusinessWeek Info Tech 100**	385.8	5.1	-31.8	-53.4
S&P/BARRA Growth	559.8	2.0	-18.6	-30.1
S&P/BARRA Value	525.1	-0.7	-17.5	-14.7
S&P Energy	812.9	-2.4	-12.8	-11.0
S&P Financials	139.0	0.4	-15.6	-9.3
S&P REIT	86.8	-3.7	-1.4	7.3
S&P Transportation	597.8	2.7	-14.3	-0.9
S&P Utilities	244.3	-8.2	-30.3	-23.5
GSTI Internet	88.4	2.5	-51.3	-74.1
PSE Technology	614.7	6.3	-24.5	-36.2

*Mar. 19, 1999 = 1000

**Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Oil & Gas Drilling	34.0	Engineering & Constr. 75.6
Communications Equip.	23.7	Toys 58.2
Toys	20.6	Paper Containers 46.9
Oil-Well Equip. & Svcs.	19.8	Pollution Control 46.8
Leisure Time	19.6	Gold Mining 42.8

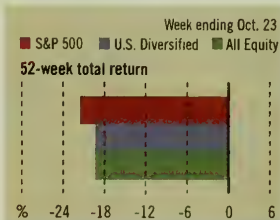
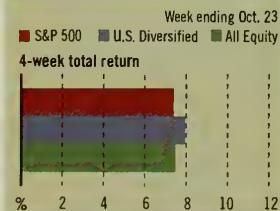
EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Technology	13.7	Precious Metals	25.2
Health	12.2	Real Estate	11.1
Natural Resources	10.8	Small-cap Value	9.4
Large-cap Growth	10.1	Mid-cap Value	6.8
Laggards		Laggards	
Precious Metals	-2.3	Technology	-58.2
Utilities	-0.1	Communications	-54.4
Real Estate	0.4	Mid-cap Growth	-37.2
International Hybrid	3.6	Japan	-36.2

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
ProFunds UltraOTC Inv.	561.6	Potomac Internet Short	147.5
Fidelity Sel. Energy Serv.	25.8	Rydex Dynamic Vent. 100	114.0
Cr. Suisse W.P. Jap. Sm. Co.	25.5	ProFunds UltraShort OTC	107.1
Conseco Science & Tech A	25.2	Schroder Ultra	81.9
Laggards		Laggards	
Rydex Dynamic Vent. 100	-30.9	Berkshire Focus	-86.3
ProFunds UltraShort OTC	-30.6	Berkshire Technology	-86.1
Potomac Internet Short	-18.7	Van Wagoner Technology	-83.9
Rydex Arktos Investor	-15.7	Van Wagoner Post Venture	-83.9

Mutual Funds



Data: Standard & Poor's

GLOBAL MARKETS

	Oct. 24	Week	% change Year to date
S&P Euro Plus (U.S. Dollar)	1030.1	1.2	-27.7
London (FT-SE 100)	5167.6	-0.7	-17.0
Paris (CAC 40)	4486.4	1.7	-24.3
Frankfurt (DAX)	4811.8	3.6	-25.2
Tokyo (NIKKEI 225)	10,802.2	0.4	-21.6
Hong Kong (Hang Seng)	10,243.5	-0.2	-32.3
Toronto (TSE 300)	6896.9	-0.9	-22.8
Mexico City (IPC)	5708.3	3.0	1.0

FUNDAMENTALS

	Oct. 23	Wk. ago
S&P 500 Dividend Yield	1.44%	1.42%
S&P 500 P/E Ratio (Trailing 12 mos.)	39.3	36.1
S&P 500 P/E Ratio (Next 12 mos.)*	20.6	20.6
First Call Earnings Surprise*	1.18%	1.89%

*First Call Corp.

TECHNICAL INDICATORS

	Oct. 23	Wk. ago
S&P 500 200-day average	1208.8	1214.8
Stocks above 200-day average	38.0%	41.0%
Options: Put/call ratio	0.73	0.65
Insiders: Vickers Sell/buy ratio	1.60	1.92

WORST-PERFORMING GROUPS

	Last month %
Conglomerates	-20.2
Savings & Loans	-14.2
Long-Dist. Telecomms.	-12.7
Regional Telephone Cos.	-11.5
Specialty Chemicals	-10.4
Communications Equip.	
Computer Systems	
Defense Electronics	
Semiconductors	
Instrumentation	

Interest Rates

KEY RATES

	Oct. 24	Week ago
MONEY MARKET FUNDS	2.60%	2.74%
90-DAY TREASURY BILLS	2.16	2.21
2-YEAR TREASURY NOTES	2.69	2.77
10-YEAR TREASURY NOTES	4.59	4.57
30-YEAR TREASURY BONDS	5.33	5.31
30-YEAR FIXED MORTGAGE†	6.58	6.57

†BansQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.02%
TAXABLE EQUIVALENT	5.83
INSURED REVENUE BONDS	4.23
TAXABLE EQUIVALENT	6.13

THE WEEK AHEAD

CONSUMER CONFIDENCE Tuesday, Oct. 30, 10 a.m. EDT ► The Conference Board's consumer confidence index for October probably fell to 96.9, from 97.6 in September. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies.

GROSS DOMESTIC PRODUCT Wednesday, Oct. 31, 8:30 a.m. EDT ► The Commerce Dept.'s advanced look at third-quarter economic growth is projected to show

that real GDP contracted by 0.8%, the first decline since the first quarter of 1993.

PERSONAL INCOME Thursday, Nov. 1, 8:30 a.m. EDT ► Personal income likely grew 0.3% in September, while consumer spending probably dropped 1%.

PURCHASING MANAGERS' INDEX Thursday, Nov. 1, 10 a.m. EDT ► The National Association of Purchasing Management's September index of industrial activity likely slipped to 46%, from 46.6% in August.

CONSTRUCTION SPENDING Thursday, Nov. 10 a.m. EDT ► Building outlays in September probably remained unchanged.

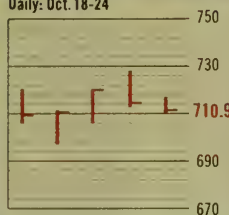
EMPLOYMENT Friday, Nov. 2, 8:30 a.m. EDT ► Nonfarm payrolls probably declined 250,000 jobs in October, with manufacturers forecast to shed 83,000 jobs. Unemployment rate likely hit 5.1%.

FACTORY INVENTORIES Friday, Nov. 2, a.m. EDT ► Manufacturing inventories probably fell 0.5% in September.

Apr.

Oct.

Daily: Oct. 18-24

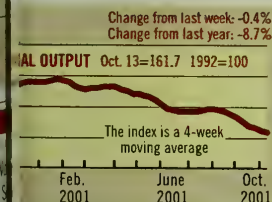


ended the week 1.3% in the red, dragged down by a stomach-turning 67.5% plunge in Providian losses on its stock to over 90% since March 1. Lower oil prices weakened El Paso, Phillips Petroleum, Exxon Mobil. The bright spots were among technology issues: Set-top box maker Scientific Atlanta up 32.6%, followed by Mercury Interactive, up 15.9%, and data storage giant EMC, up 11.3%.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	3.1	-8.8	26	Verizon Communications	-4.8	3.4
Petroleum	1.2	-11.7	27	Citigroup	0.8	-3.5
	-11.7	-46.9	28	Sun Microsystems	4.4	-54.2
	-15.9	-20.6	29	Merck	-3.0	-16.0
Materials	10.0	-22.0	30	El Paso	-9.5	-32.7
Financial	-67.5	-91.6	31	Altera	9.0	-16.9
Petroleum	-2.4	5.5	32	Marsh & McLennan	-0.6	-3.4
	1.3	-16.7	33	Household International	-3.0	-5.1
Gee	-1.7	-14.4	34	ChevronTexaco	-2.5	0.1
	7.3	-31.4	35	SBC Communications	-9.2	-13.8
Brothers Holdings	2.9	-8.3	36	Mercury Interactive	15.9	-54.9
	11.3	-70.9	37	AOL Time Warner	4.2	-27.0
	-8.1	-75.9	38	Washington Mutual	-6.4	-8.3
Laboratories	-0.2	10.4	39	General Dynamics	-0.9	23.7
Financial	5.5	-14.8	40	Comcast	-0.2	-16.6
Technology	8.4	-37.6	41	Morgan Stanley Dean Witter	-4.8	-21.4
	6.1	-29.8	42	Tellabs	-2.5	-70.6
Hess	-6.8	-14.4	43	Exxon Mobil	-3.8	-2.1
Energy	-6.7	-10.3	44	Scientific Atlanta	32.6	-49.3
Communications	3.8	-56.0	45	U.S. Bancorp	1.7	-21.7
Financial	-4.3	-17.8	46	Paychex	3.9	-15.3
Petroleum	-2.1	4.1	47	Merrill Lynch	1.9	-24.9
Devices	-2.6	-6.0	48	Bed Bath & Beyond	-1.2	7.3
Sources	2.6	-20.1	49	Texas Instruments	-0.2	-7.9
Health	-4.2	6.6	50	Teradyne	2.6	-29.7

Production Index



Production index declined again this week. Before the four-week moving average, the index to 161, from 161.3. After seasonal adjustment production was down for the fifth time and on Oct. 22, a U.S. trade panel ruled steelmakers have been the victims of practices by foreign producers. Rail-freight trucks, and coal were also lower. Autos and lumber were up, and lumber was unchanged. The index components is at www.businessweek.com. Copyright 2001 by The McGraw-Hill

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PRIVACY VS. SECURITY: TREAD CAREFULLY

We the people of the United States, in order to form a more perfect union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity, do ordain and establish this Constitution for the United States of America." So begins the Preamble to the Constitution and the delicate negotiation between citizens and state that has so defined America. The preamble establishes not only the principle that government derives its power from the people but also that individuals decide which freedoms to curtail and delegate in exchange for the security promised by government. During America's long history, that deal has often been renegotiated, especially in time of war. And the dialogue is starting once again.

It seems necessary for Americans to give up a measure of privacy to combat terrorism (page 82). In exchange, they have the right to demand that the government follow three principles. First, the surrender of specific liberties must be temporary, not permanent. Second, increased surveillance must be audited by the courts and documented. Finally, individuals must be able to see data files on them—and correct the information.

The government is relying on technology to combat terrorism. It is asking to integrate databases of police, intelligence agencies, and, at times, private corporations such as

credit-card companies and airlines. It is discussing facial recognition software, public cameras, and other devices to monitor movement. It wants increased powers to use Carnivore software to eavesdrop on digital communication via e-mail, cell phones, and personal digital assistants. There is growing pressure for "smart" national ID cards. Add it up and it's a lot of privacy to give up in the name of security.

Americans say they are willing to do it. A recent Harris Poll shows that 86% favor wider use of facial surveillance, 81% want closer monitoring of bank and credit-card transactions, and 68% support a national ID card. If such a card is necessary, Washington should mandate that only a minimum of data be included: perhaps name, address, fingerprint, blood type, U.S. citizenship, immigration status, country of origin, and visa status.

For a nation of individuals incredibly protective of their rights and liberties, the polls reflect a dramatic showing of trust in government. Just a year ago, polls showed Americans worried about commercial encroachments on their privacy from data marketing companies to credit bureaus. They still are worried but appear to trust the government to maintain the right balance in a time of crisis. Washington must not abuse this trust. The people will reclaim their rights when the emergency is over, as they have after every war.

WHY PRODUCTIVITY WON'T PLUMMET

At a time of bioterrorism and war overseas, it is difficult to address the long-term economic health of the nation. But we must. Will the double shock of higher spending for national defense and corporate security plus the bursting of the high-tech stock bubble end the productivity gains of the 1990s? To a remarkable degree, the consensus answer among economists and policymakers is "no." Half of the huge gains in productivity made in the '90s will stick. That means productivity can grow at around 2% a year, permitting the economy to expand at 3% a year. It is now clear that the low-productivity era between 1973 and 1995 was a historic anomaly: The U.S. is now returning to its long-term trend. And for a nation feeling that it's under siege, this is good news indeed (page 36).

Productivity will certainly suffer a one-time hit as corporations shift spending toward securing their employees and operations. Terrorism is throwing sand in the efficient, just-in-time global system that is at the heart of so much productivity growth. Goods, services, and even money are moving more slowly around the world as security checks are made. But corporations are already reconfiguring their supply-chain-tracking software to ensure security across borders. This process doesn't have to take long. The greater fear is that higher defense spending will act as a tax on the economy, reduce the budget surplus, raise interest rates, and curb investment.

The "peace dividend," which came with the drop in defense spending from 8% of gross domestic product in the 1980s to 3.9% in the '90s, was linked to a surge in productivity.

Despite big increases, military spending isn't about to approach its cold war levels. Information more than missiles, squads of commandos rather than battalions of infantry, are the tools of the war on terrorism. If defense spending rises \$50 billion, the maximum being discussed in Washington, would boost military expenditures to 4.5% of GDP. That would slice perhaps 0.1% off the underlying growth rate of productivity. A smidgen.

The greater threat to productivity growth may be the mundane erosion of competition and innovation. A recent McKinsey & Co. report argued that the spread of information technologies was a necessary, but not sufficient, factor in boosting productivity. Deregulation, for example, helped open markets and create the competitive environment that technology-motivated managers used to create new products and lower costs worldwide. Productivity could suffer if Washington begins to bail out too many industries under the guise of national security or if tax-and-spend policies eviscerate the budget surplus.

The bottom line: Productivity gains in the decade ahead may be more muted than during the hyper '90s, but they appear to be substantial nonetheless and sustainable. Not bad.

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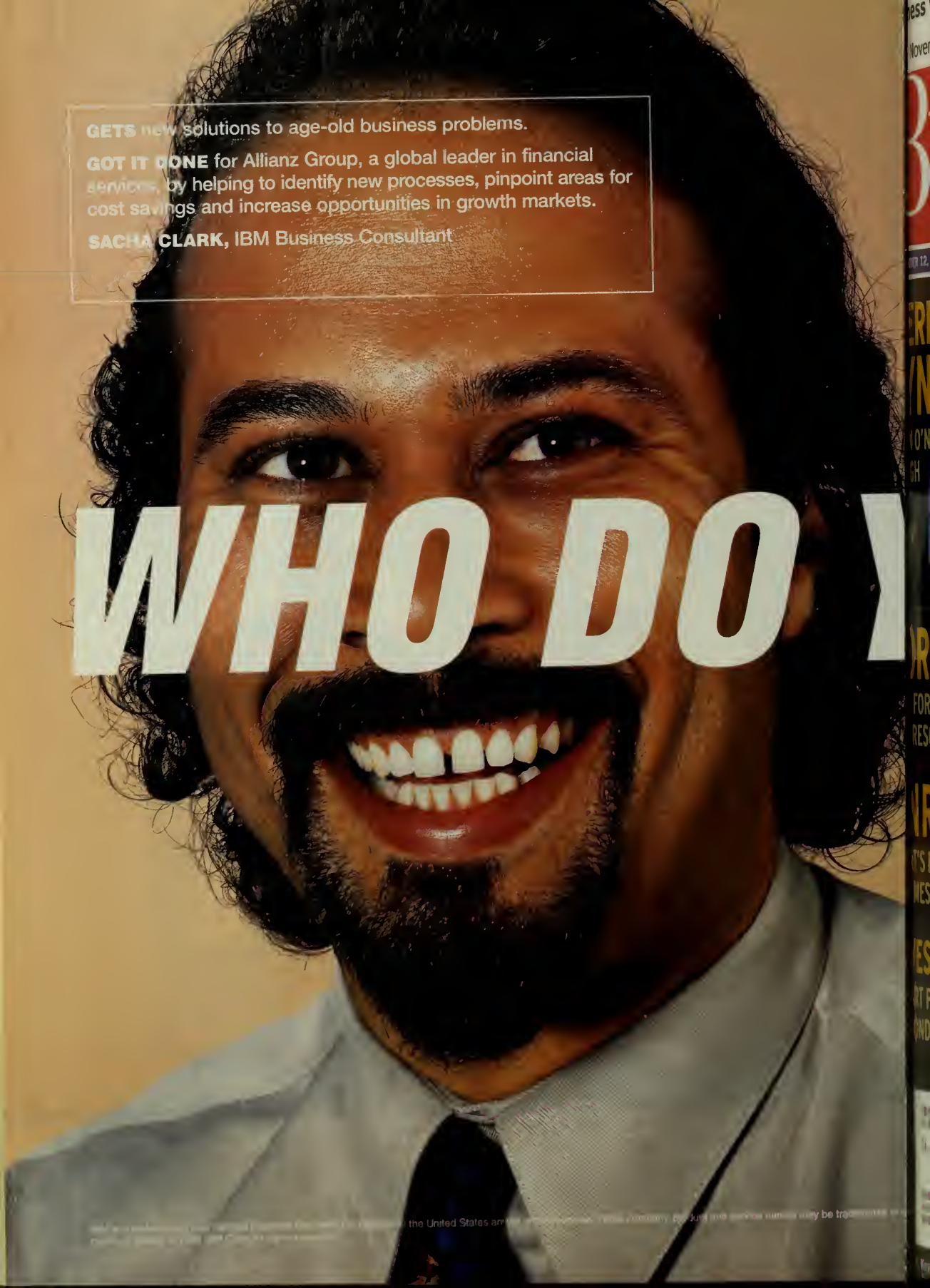
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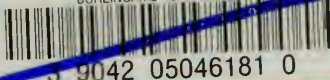
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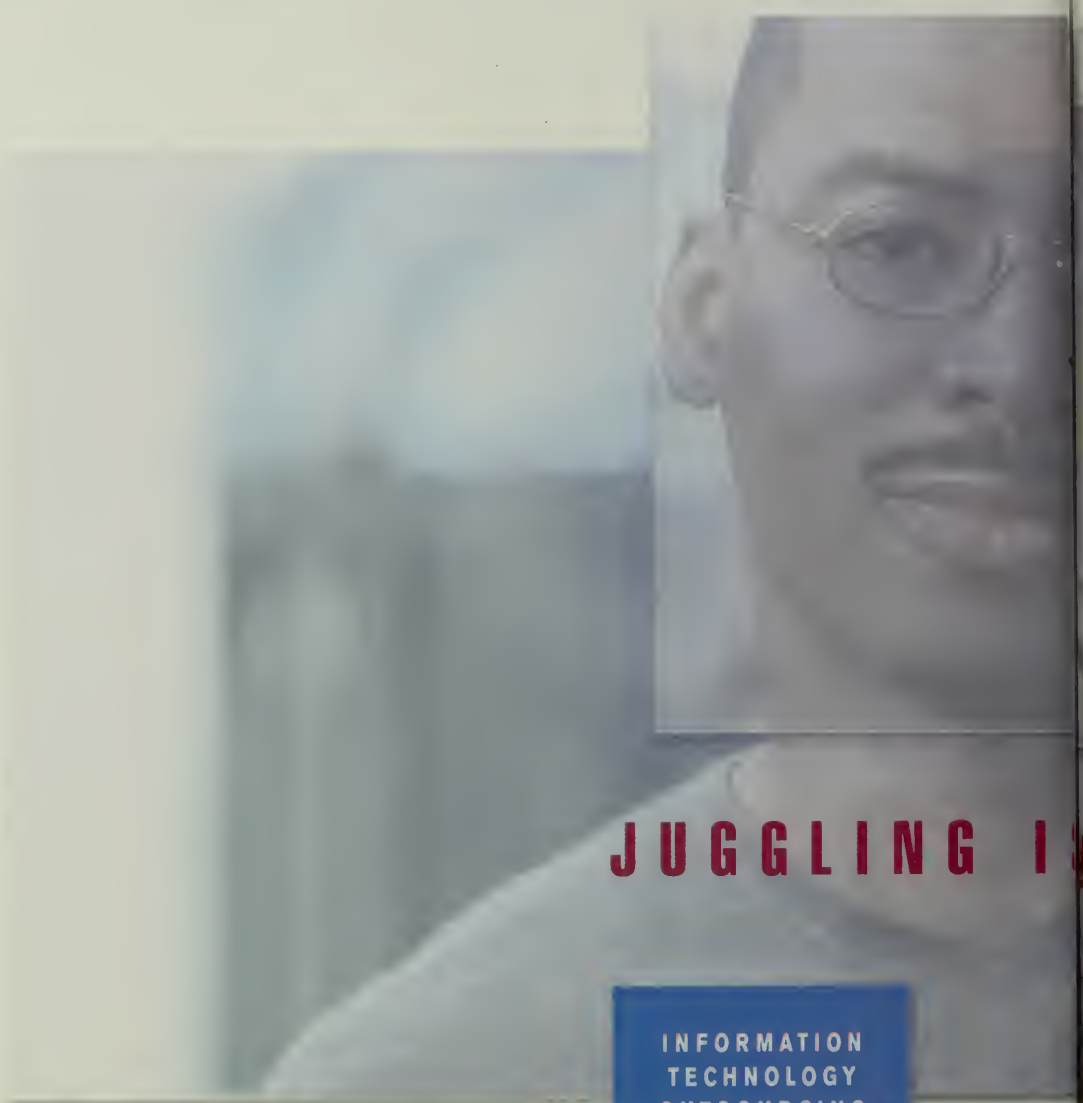
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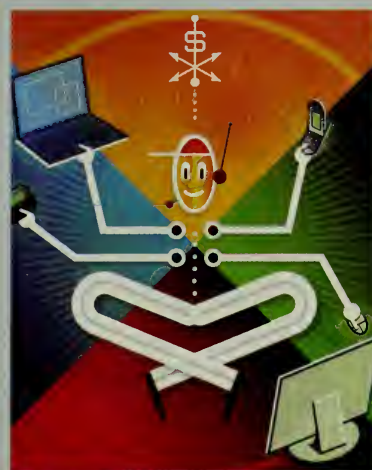
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Look, Ma—no
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TECHNOLOGY BUYING GUIDE



TECHNOLOGY GUIDE
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Great XPeCtations?

Despite Microsoft's all-out push, XP's prospects are dimmed by a bad economy, global tensions, and complicated licenses



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Can she take a crack at this?

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Up Front

EDITED BY SHERIDAN PRASSO

PLANE TALK

SALE OF THE DECADE, BUT WILL IT FLY?

AIRLINES ARE HURTING BAD. Travel is still down by double-digit percentages, according to the latest Travel Business Roundtable survey released on Oct. 31. So airlines have launched a desperate plea to get people back in the air.

With fares not seen since the recession of the early '90s, every major carrier is on board. American has christened its sale, "The Great American Get-Together." Southwest is selling \$39 fares between California cities. Delta, with \$31 one-way flights from Atlanta

to 32 cities, has started partnerships with El Al Israel and with New York City. Continental and American are awarding double mileage. United is running long TV ads in attempts at reassurance.

The question is whether airlines can break even. "We're not making money at those kinds of fares," says



FLYING LIGHT: Desperate pleas

Southwest's chief financial officer, Gary Kelly. "To have a business, we'll need fares to get back to normal levels." Yet, as transportation analyst Daniel Kasper at consultants LECG notes: "They may well be losing money, but it's the best they can do under the circumstances."

S.P., with bureau reports

HOSPITAL HICCUPS

ADDING TO THE HEALTH WORRIES...

WITH HEALTH SCARES EVERYWHERE, THERE'S A STUDY IN THE *New England Journal of Medicine* that shouldn't be taken lightly. It found death rates are 6% higher for many leading causes of death when patients enter hospitals on weekends.

Sparse staff with less experience is the most likely culprit, say the authors, who analyzed 3.8 million patient records at hospitals in Ontario from a 10-year period. "Not only are there fewer workers in a hospital on weekends, but also those that are on are less senior, and they're less supervised," says article co-author Dr. Chiam Bell, an internist at Sunnybrook & Women's College Health Science Center in Toronto. Plus, he adds, weekend staffers are often overburdened with tasks usually done by support staff.

While the American Hospital Assn. questions the relevance of a study done in Canada to U.S. facilities, Bell says the findings apply to any hospital with lighter weekend staffing—and that includes most of those in the U.S. and the Western world. His recommendation: "People who are sick shouldn't put things off until the weekend." However, getting sick on the weekend doesn't mean you should wait till Monday. Delay itself is a greater risk, he says.

Carol Marie Cropper

TALK SHOW "ID cards must be shown to get into the building no matter how bad the photo is."

—Security sign in the lobby of New York advertising agency Ogilvy & Mather, as quoted in *The New York Times*

SILICON CULTURE

REQUIEM FOR DOS

MICROSOFT CHAIRMAN BILL Gates marked the end of an era when he took the stage in New York on Oct. 25 and introduced Windows XP, the latest operating system. While its point-and-click features are whizzy, one thing is missing: MS-DOS, the engine of the PC since its 1981 debut.

DOS, at last, is dead. Gates marked the moment by typing the word "exit" for the last time on the once-familiar black screen. Back before Windows, people used to have to type arcane DOS commands—like, "copy memo.txt c:\memo" to copy a file. And, still present in earlier versions of Windows, DOS was blamed for frequent crashes—including the dreaded "blue screen of death." Few will mourn its passing.

Yet DOS created a phenomenon. Written by Tim Paterson at Seattle Computer in

1980, Microsoft bought it a paltry \$50,000. It sparked one of the greatest explosions of wealth in history. Today Microsoft is valued at \$3 billion; Gates's stock is worth \$41 billion. "They should wish DOS," says Dwight Dyer, an analyst for Summit Str



gies who began tracking Microsoft in 1978. "It was the foundation for Microsoft's domination of an industry."

So what does Paterson think? "I have no regrets seeing it go," he says. "I rather point and click." Paterson later joined Microsoft, retired on his stock option and now, for fun, designs robots for Comedy Central's BattleBots contests. No, the robot isn't named DOS. It's HexaDecimator. *Steve Har*

THE LIST CEO SHAKEOUT

At least a half dozen CEOs have been ousted or have resigned since September 11. Here are the highest-profile, starting with the most recent departures:



JACQUES NASSER
Ford Motor

Poor financial performance; clash with homey Ford culture; failure to fix Firestone fiasco (page 50)



PETER BONFIELD
British Telecom

Acquisition strategy burdened BT with \$44 billion debt and split the company



LARS RAMQVIST
Ericsson

Presided over growing losses; missed the trend to low-end phones



JAMES GOODWIN
UAL

Massive losses; failed takeover of US Airways; concessions to pilots' union resulting in high costs (page 62)



SHAILESH MEHTA
Provident

Large loan losses; paid \$400 million to settle charges of imposing unnecessary fees

today's
business
thought:

what's the
best use
of your company's
time and money?

hint:
it isn't
managing
IT infrastructure.



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Up Front

DRAWN & QUARTERED



ONTARIO: The toll of terrorism

tail stores report sales down as much as 50%.

Windsor, Ont., just across from Detroit, "is dying on the vine," says Richard Blouse,

president of the Detroit Chamber of Commerce. About 7.5 million day-trippers cross the Detroit River into Windsor each year, but traffic is now at half pre-attack levels. A crossing that used to take a few minutes now can take hours. "If things are going to bounce back, it's going to take a very long time," says a spokesman at the large Windsor Casino, which laid off 762 employees.

Already, border hassles have caused more than a dozen of the 1,600 Canadian nurses in Detroit-area hospitals to quit; Canada's nursing grads are eschewing U.S. job interviews, adding to the nursing shortage here.

There's pain on both sides of the border. Hawthorne Consulting, based in Vancouver, closed its office in Blaine, Wash., on Oct. 12 because Canadian employees were waiting up to two hours to cross. "We all agree with the new security measures, but we're just getting wiped out," says CEO Owen Anderson.

The Niagara region, too, finds business down 25%, says Carolyn Bones, president of Canada's Niagara Chamber of Commerce. "We've tended not to think about the fact that there is a border," she says. They're certainly thinking about it now. Kimberly Weisul

NORTHERN EXPOSURE

CANADA GETS THE BORDER-DELAY BLUES

SEPTEMBER 11 WAS A TURNING point for the U.S. economy. But the terrorists also landed a body blow in Canadian towns whose prosperity has long hinged on easy cross-border travel.

Now, with tightened security and wait times at crossings unpredictable, cross-border workers are quitting their jobs, and stores and restaurants that counted on Americans taking advantage of the weak Canadian dollar are hurting badly. Border re-

HEARTLAND INSECURITY

ON THE PROWL FOR GUARDS

THE JOB OUTLOOK MAY BE DIM, but hiring is booming for one specialty: security guards. Demand will jump 8% to 10% over the next few months, says Robert McCrie, professor at New York's John Jay College of Criminal Justice.

With 1.1 million guards nationwide in jobs that generally pay \$8 to \$12 an hour, that means 100,000 new slots—at least temporarily. Increased airport security could account for 28,000 of them.

At the moment, there are

more jobs than seekers. "we could take on 5,000 more we could find them," says spokesman for security firm Wackenhut, which employs 25,000 guards nationwide.

But up to half the new jobs could turn out to be temporary. Other companies taking a more comprehensive look at security needs, they will install surveillance cameras, reroute foot traffic, and consider identification systems that require less manpower to maintain, says Gary Schiff, head of security services at Kruger. For now, though, guards are a quick solution and one that will create jobs. Kimberly Weisul



SEARS TOWER: Numbers in safety

THE WELCH WATCH

Jack Welch, one of America's most visible chief executives, is now one of its most high-profile retirees. Since leaving General Electric on

Sept. 7, Welch has become:

- Adviser to J. P. Morgan Chase CEO William Harrison
- "Special partner" at investment firm Clayton, Dubilier & Rice
- Best-selling author (with John Byrne of *BusinessWeek*) of *Jack: Straight from the Gut*. Sales so far: Nearly 300,000
- Emerging political pundit, holding forth on Manhattan, the recession, geopolitics, and, of course, the Environmental Protection Agency's decision to make GE pay \$460 million to clean up the Hudson River.

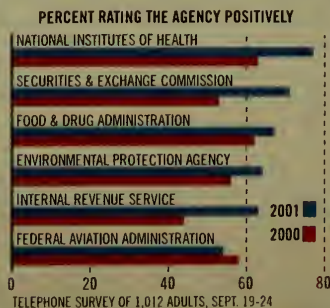
So much for that golf handicap.

Diane Brady

THE BIG PICTURE

WARM FUZZY FEELINGS FOR GOVERNMENT

With terror striking the nation, Americans view their federal agencies more warmly than before.



Data: Harris Interactive

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WILL THE BIG APPLE KEEP ITS SHINE?

If New York City was able to recover from the devastating fire of 1835 that destroyed 700 buildings, it can certainly return to glory from this most recent disaster ("The future of New York," Cover Story, Oct. 22). The U.S. must recognize that New York is the economic and intellectual center of our nation and do what is required to rebuild.

New York has balanced its budget for the past 20 years; the country can reward this fiscal discipline and can speed recovery by appropriating the additional \$54 billion in incentives, tax breaks, and subsidies that the city has requested. Even at a total of \$71.5 billion (including the \$17.5 billion granted in September), the fact that a healthy New York City sends \$9 billion a year more to Washington than it receives back in aid further justifies this commitment.

I have been a *BusinessWeek* reader for many years and always look forward to each issue. Keep up the good work: Your readers depend on it.

Erik L. Johansson
West Hartford, Conn.

It almost seems implausible that cities have utility. As a political anthropologist, I must constantly remind myself of the following: The renaissance began the process of pooling resources for public solutions. Microsoft Corp. Chairman Bill Gates has taken those powers and invested them in private individuals. No, for some time now, New York City has not had a future. The

new cities are found on the Internet and not in any physical locale. To the otherwise is to obscure reality.

Thomas S. So
Neenah, Wis.

London did not die at the end of British Empire. But it was never quite the same, either.

Gary Ander
Brooklyn, N.Y.

I am a survivor of the Kobe earthquake in Japan, and New York is second home. Right after the big earthquake, our community united

rebuild Kobe, just as New Yorkers are doing now in my neighborhood, until service came back at one month. In three five months, the highways were repaired, and public transportation was up and running. People lived in temporary units for one two years until permanent houses were built. Eventually worked physically and mentally to rebuild city. And Kobe's baseball team, the Orix Blue Wave (Ichiro Suzuki's former team in Japan), won the series for Kobe's citizens that year.

Gary Becker points out that Kobe citizens rebuilt the city in one year ("Don't be surprised if the recovery rapid," Economic Viewpoint, Oct. 22). The recovery of New York may not quite so speedy, because the city suffered a terrorist attack and not a natural disaster. We had only one goal: build the city we loved.

Now, people all over the world are angry, scared, and worried. There are many things to be accomplished and many problems to be solved. I hope



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Readers Report

CORRECTIONS & CLARIFICATIONS

Because of an editing error, the display language introducing the lead story of News Analysis & Commentary (Nov. 5) misstated the thrust of the article. It should have read: "Productivity: The real story. Its growth is slowing, but many of the New Economy gains will survive."

Breaking free of the corporate pack" (Books, Oct. 29), a review of *Good to Great* by Jim Collins, should have included Fannie Mae in the list of 11 companies profiled, and not Federal Home Loan Mortgage Corp.

No silver lining for tech sales" (Up Front, Oct. 22) incorrectly reported that Dell Computer Corp. shipped replacement PCs to Morgan Stanley Dean Witter & Co. after the September 11 attacks. Dell has sold more than 24,000 replacement PCs and servers, but none of them to Morgan Stanley.

World leaders will take wise steps to bring peace again.

Taeko Kondo
Carmel, N.Y.

QUEST OF EXCELLENCE QWEST

I am very disappointed by "On the long line at Qwest" (Information Technology, Oct. 29). The story reports—unfairly—the efforts of a few Morgan Stanley analysts to impugn my character and Qwest's integrity as a distraction while regulators and investors criticize Morgan Stanley for the well-known animosity between its analysts and the companies they cover.

Qwest has always disclosed its financial condition and results of operations in accordance with generally accepted accounting principles (GAAP). We certainly did not put out information intended to support growth projections that we do not believe. And there was certainly nothing "inevitable" about our downward guidance on September 10, if by that the *BusinessWeek* reporter meant to imply that our financial disclosure somehow misstated our real growth rates.

We took our numbers down on September 10 after reviewing economic data and internal sales information in the August and early September that showed the nation and our 14-state eastern region heading for a longer, deeper recession than most people had predicted even a month earlier. We also were aware that the deteriorating economy was beginning to affect the mix of

products and services we sell our wholesale customers. They were beginning to move away from purchases of capacity—called indefeasible rights of use (IRUs)—on our national fiber-optic network and toward shorter-term lease arrangements for that capacity.

We are in good company. Other telecommunications companies have recently reduced their own guidance, and some of them have done so because they observed the same trends in the wholesale market.

I suppose that the article shouldn't have been all that surprising, as we've never had a particularly good relationship with your magazine. Two years ago you said Qwest made a "colossal mistake" in bidding for US West, that Qwest couldn't capture US West, and that, in any case, Qwest couldn't produce any operational synergies from the acquisition.

Wrong on all counts. Today, we're a company with a strong balance sheet, significant cash flows, and the most technologically advanced network in the world, and we're almost ready to re-enter the long-distance market in our 14-state local-service market that we had to surrender when we closed our acquisition. In fact, our acquisition is often cited as one of the most daring and prescient transactions of the last decade, where a decidedly New Economy firm buys a decidedly Old Economy firm—and thrives afterwards.

Your reporter seems to think I've lost a little of my zip. So there's no doubt, let me repeat that I am still very confident that Qwest is the new model for the telecommunications industry. This chatter about accounting issues is beside the point. The misfortunes of our national and regional economy, along with investors' flight from growth stocks to the value and dividend plays, may slow our emergence as an industry leader. It will happen when the economy recovers and investors again turn to growth stocks.

We take some comfort in the well-known line from the early days of the Clinton Administration, "It's the economy, stupid." How could your reporter have forgotten it?

Joseph P. Nacchio
Chairman and CEO
Qwest Communications International
Denver

THIS ANTHRAX ANTIDOTE ISN'T READY FOR PRIME TIME

"Seeking an anthrax cure in your spice garden" (Developments to Watch, Oct. 22) correctly points out that my tests with oregano oil showed promising

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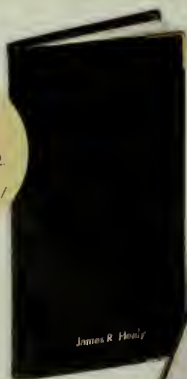
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Readers Report

results when used to treat staphylococcus (staph) infections in mice. However, I personally have never tested oregano oil—or any other substance—on anthrax. The test-tube results described in the article were not obtained at Georgetown University.

Harry G. Preuss, M.D.
Georgetown University Medical Center
Washington, D.C.

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VENTING THE ELECTRONIC CENTURY

The Epic Story of the Consumer Electronics and Computer Industries

by Alfred D. Chandler Jr.
Free Press • 321pp • \$35

HOW TECH COMPANIES GROW BIG AND STRONG

Alfred D. Chandler Jr. is the Boswell of big. As the dean of American business historians, he has chronicled such megacorporations as DuPont, General Motors, and Standard Oil. His work has provided much of the intellectual foundation for postwar management theory and practice. In fact, he won the Pulitzer Prize in 1978 for *The Visible Hand*, in which he takes on the classical theories of Adam Smith. There, Chandler concluded that the management of corporate giants had superseded market mechanisms as the defining element of economic activity.

Chandler, a Harvard University professor emeritus, has now turned his attention to the world of transistors and microconductors, a field associated these days with a garage culture of brash startups. The result is *Inventing the Electronic Century: The Epic Story of the Consumer Electronics and Computer Industries*. Scale and scope are still what matter to Chandler, however, even as the world economy moves from what he calls the Industrial Century, the 20th, to the Electronic Century. While he analyzes the early days of Microsoft Corp., Apple Computer Inc., and others, he feels that it is today's computer giants that are at last poised to play out his theories in earnest. The book is rich in insights, but the attempt to apply lessons from consumer electronics to information technology ultimately seems strained.

As Chandler sees it, high-technology industries are defined by what he calls paths of learning. "In market economies the competitive strengths of industrial firms rest on learned organizational capabilities," he says. A company springs out of an individual's knowledge, which evolves into organizational knowledge consisting of three basic strengths: technical prowess, mainly research; func-

tional knowledge such as production and marketing; and managerial expertise.

This knowledge base points the way to new businesses where a company can succeed. And it creates a barrier to entry that is especially intimidating to startups. Once a company has built its learning base to the point where it has become a core company in an industry, says Chandler, "entrepreneurial startups are rarely able to enter. Instead, the core companies' competitors are either foreign core companies or domestic core companies in other industries."

The thesis stands up well as Chandler tells the story of the consumer electronics industry. The U.S., Japan, and Europe were all home to pioneering companies that sprang from products as disparate as bicycle lamps, in the case of Matsushita Electric Industrial; radio transmitters, in the case of RCA; and light bulbs, in the case of Philips. RCA, which was originally a subsidiary of General Electric Co., was initially the most prominent of the group, thanks largely to wartime contracts for radio-tube research and production and later to its advances in television technology. Matsushita did not advance its technology prowess much during the war, but made up for lost time afterward as it met booming Japanese consumer demand.

The U.S. and European companies were eventually undone by their own gaffes and the onslaught of the Japanese. RCA, for example, pared back research and development on consumer electronics as it tried to launch a computer business and diversified as far afield as car rental and frozen foods. Meanwhile, Matsushita, Sony Corp., and other Japanese companies enhanced their mass-production skills and developed new products, some of them based

on U.S. innovations such as the transistor and the video recorder. By the 1980s, the triumph of Japanese companies was inevitable.

When it comes to the computer industry, Chandler's thesis begins to fray at the seams. Here, what Chandler calls the path definer was just one company: IBM. Big Blue certainly fills the bill in terms of a company that built—and still possesses—an impressive set of technical, production, and managerial skills. But the competitors it faces today include Microsoft, Sun Microsystems, and SAP, companies that didn't even exist three decades ago. What's more, these recent upstarts succeeded where other sizable U.S. insurgents, such as GE, RCA, and Honeywell, failed in the decade before the birth of the PC.

Despite this, Chandler feels that large, more integrated Japanese companies, such as Fujitsu, Hitachi, and NEC are likely to be more important than upstarts. The case for the Japanese is their resourcefulness—demonstrated by the revival of their sagging computer fortunes in the 1970s—a diversified

product mix, and a single supporting nexus, as Chandler calls it. The nexus is the concentration of producers and their parts suppliers in just two metropolitan areas—Tokyo and Osaka—only a few hours apart by train.

While no one underestimates the Japanese, Chandler's reasoning will startle U.S. high-tech executives. Concentration is fine. But an economy and information-technology industry as large as America's can surely support more than one high-tech hotbed—and it does. Venture capital is also a bigger plus on the U.S. side than Chandler makes out, seeding the Microsofts of the future as well as innovative companies that wind up being purchased by the likes of Cisco Systems or IBM. In a fast-moving world where new technology replaces old at a furious pace, one of the more striking realizations from Chandler's book is that the U.S. high-tech industry was able to lose an RCA, indeed a whole sector, and barely miss a beat. Diversity, fueled by a robust business-formation process, goes a long way toward explaining why.

BY G. DAVID WALLACE

Wallace is assistant managing editor for technology coverage.



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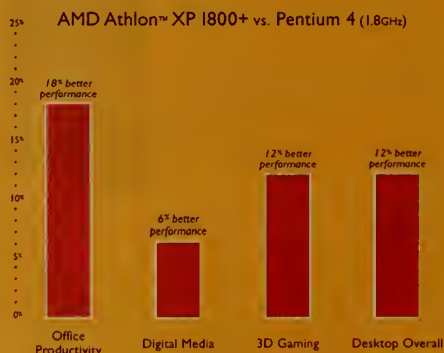
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*Taken from "Inside the Nexbus: The Micro-Architecture of the Intel® Pentium® 4 processor, revision 1.0," Intel Corporation 2000.

**Based on eTesting Labs, Inc. Content Creation Winstone™ 2001, v1.0 benchmark comparing an AMD Athlon XP processor 1800+ with QuantSpeed architecture to a 1.8GHz Intel Pentium 4 processor. QuantSpeed architecture operates at 1.533GHz. See www.amd.com for system configuration information and specific benchmark results.

BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

SECURITY-CHALLENGED AT MICROSOFT



Problematic downloads of patches can jeopardize the safety of entire networks

In last week's column, I took a look at how Microsoft included solid security features in Windows XP but left it up to consumers to make them work. The XP experience turns out to be a typical one for Microsoft: Turning its attention to security issues, the company is getting things half right.

Consider the saga involving Office programs that started on Oct. 4. Microsoft alerted subscribers to a security bulletin detailing a problem in versions of Excel and PowerPoint for both Windows and Macintosh. Such security notices, which usually include instructions for fixing the hole, come out once or twice a week, and the issues range from obscure vulnerabilities in Windows 2000 servers to problems—like this one—that could jeopardize millions of PCs.

The issue described by bulletin MS01-50 was nasty. Microsoft warned that, under some circumstances, a malicious program, or "macro," attached to an Excel spreadsheet or a PowerPoint presentation could run when the file was opened, despite security settings in the applications that were supposed to stop automatic execution. Macros can do just about anything, from sending e-mail to everyone in your address book to deleting files. The federally funded CERT Coordination Center followed up with a warning of a "strong possibility of widespread abuse."

Fortunately, it seems that widespread abuse didn't occur. It's a good thing, because Microsoft didn't make it easy to fix the problem. I dutifully followed the links to download the patches for the Office XP versions of PowerPoint and Excel and discovered that I needed two files totaling nearly 10 megabytes—at least 10 times the size of a typical fix. The next surprise came when I attempted to install the files and was asked to agree to an End User License Agreement consisting of Microsoft legal boilerplate. But my patience snapped when Windows demanded that I insert my original Office XP installation CD to install the patch. I immediately

thought of road warriors who did the responsible thing and spent maybe an hour downloading the files over a slow hotel connection—only to discover that they couldn't complete the installation because they lacked the foresight to keep an Office XP CD with them at all times.

An e-mail exchange with an anonymous Office spokesperson failed to offer much enlightenment. The end-user license is necessary, the company said, "to protect the code from being used illegitimately." For users who don't have an Office CD available, the letter went on, "we recommend reinstalling from a network (admin source), then either using the admin patch or the client patch."

WORMS AND VIRUSES. In an effort to get through the gibberish, I spoke with Jeanne Scheldon, director of Office Sustaining Engineering Services. The need for original disks, she said, is actually imposed by Windows, not Office. The disks are not needed with Windows XP and XP. The large size of the patches was due in part to Microsoft's decision to roll in a number of fixes that had nothing to do with security,

such as correcting an error in how Excel sorts Czech-language lists. As an alternative to carrying the CD, she suggested copying its contents—a total of 449 MB for Office XP—to a laptop hard drive.

What's wrong with such suggestions? Patches only work when they are installed, and up-

dated computers can impede entire networks. The Nimda worm took advantage of flaws in Microsoft servers for which fixes had long been available but which administrators had failed to install.

The Melissa virus shut down many systems in 1999 using a hole in Word very similar to the new ones in Excel and PowerPoint.

Microsoft is doing a good thing by quickly distributing patches and notification when holes are discovered. But anything that complicates installation of the patch is a disservice to the purchasers of Microsoft products and also to the Internet community, whose security depends on the security of every computer on the Net. That means not bloating critical downloads with fixes for problems that don't affect security, keeping the installation process free of language that only lawyers understand, and avoiding requirements like having a CD on hand. Until Microsoft puts security first, we'll have to cope with halfhearted measures.



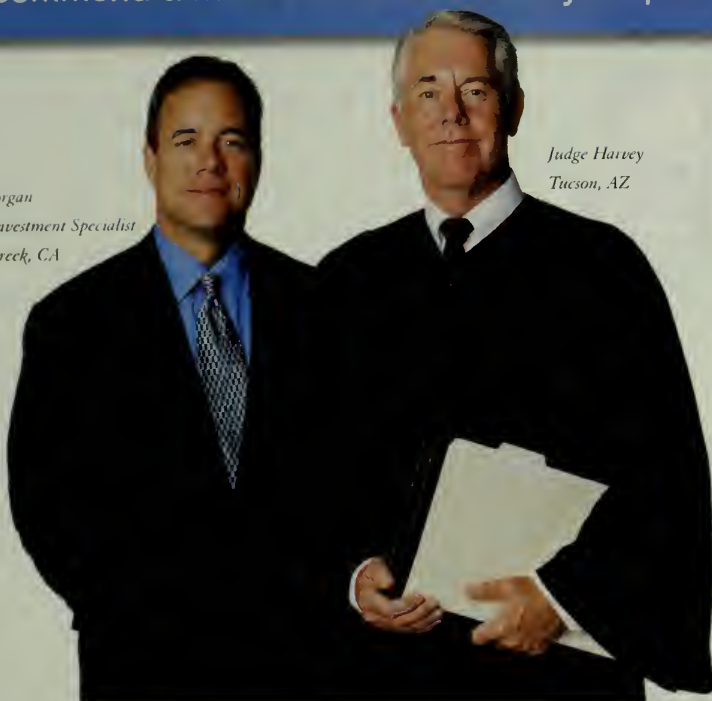
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BY JEFFREY E. GARTEN

THE BIG BOARD SHOULDN'T BECOME JUST ANOTHER COMPANY



A BEACON:
In this age of uncertainty, the NYSE's integrity and stature are too valuable to put at risk by turning it into a publicly traded corporation

The reopening of the New York Stock Exchange on Sept. 17, after just four days of closure, epitomized the defiant spirit of global capitalism that the terrorists wanted to destroy. It also ushered in a new era for the Big Board. Before the attacks, the NYSE was considered by many to be just one of several exchanges hammered by competitive pressures. The conventional wisdom was that it should become a publicly listed company, do away with its floor traders, and become a fully automated system. But now, the world has changed, and we need to view the NYSE through a different lens.

Since the late 1990s, chronic global financial crises and the spectacular crash of technology stocks were leading to a recalibration of the balance between unfettered global capital markets and the need for more oversight, tighter regulation, and higher ethical standards. The free market had become a free-for-all. September 11 tipped the scales: In place of unbridled enthusiasm for deregulation, there is now a preoccupation with our vulnerability to disruptions and wild market swings. Public institutions need to be shored up rather than torn down.

It follows that at the heart of global markets we need organizations with the unquestioned stature and integrity that no purely commercial entity can guarantee. The NYSE stands alone among stock exchanges as a candidate for such status. It plays a far more critical role in the global market than does Nasdaq or the new electronic exchanges. After all, its listings include 90% of the nation's largest 100 companies. It is attracting nearly all of the highest-quality Asian and European global corporations, from Toyota Motor Corp. to Deutsche Bank. And when there is a financial crisis, such as the 1987 stock-market crash or the 1998 Long-Term Capital Management fiasco, or September 11, it is the chairman of the NYSE who is called upon to sit with top officials from Wall Street and Washington. The Big Board has become the most visible emblem of Wall Street's global role.

HOLDING THE FLOOR. The NYSE must therefore be seen not as just another organization in the broad panoply of trading venues around the world. Instead, it should be thought of as a private institution with a public purpose, one with special national and international status.

Consequently, the concept of the NYSE as a public company that puts its shareholders' interest above all else has been overtaken by events. Why? First, the NYSE maintains spare trading capacity of more than 100% of peak loads

for unpredictable crises. Second, more than one third of its employees are involved in the exchange's self-regulatory functions. These essential costs are incompatible with what shareholders demand for quarterly profits.

In addition, the floor-based trading model should be preserved. In fact, 92% of all trades no longer touch a floor broker anyway. But as was shown during the market break of 1987, and again during the week of Sept. 17, in times of crisis floor traders and specialists can facilitate more orderly market by buying and selling at critical junctures. No wonder sophisticated investors gravitate toward the NYSE in times of turbulence. During the week of Sept. 17, for example, the Big Board's share of large block trades, those transacted by the most sophisticated investors, jumped to 90.3%, compared with the normal 78.8%.

EMERGENCY HOME. While the NYSE has made progress toward fulfilling its public responsibilities, it should redouble efforts to meet the platinum standard for both self-regulation and for the accounting and corporate-governance systems of the companies it lists. Half of its board of directors should unambiguously represent the public interest—not just those of Wall Street and Corporate America—and should be selected by an independent blue-ribbon group established by Congress.

NYSE Chairman and CEO Richard Grasso has been superb, but there's no assurance that his successors will measure up. Therefore, only the independent directors representing the public interest should be involved in picking future chairmen. To fill the post, they should reach for people who embody the standards of leadership such as the chairmen of the Federal Reserve and the Securities & Exchange Commission. Finally, Washington ought to consider financing the physical security needs of the NYSE, including an alternative site for emergencies, not as a subsidy for New York City but in support of a vital American institution.

Of course, the NYSE must remain competitive. But it has more than held its own these past five years by maintaining market share of 83% to 85% in the trading volumes of the companies it has listed. It must also be able to afford excellent technology and talent. Acting as a private company, however, it has still been able to marshal the resources to do this, even in the expensive 1990s.

Out of crises can come important decisions. Elevating the NYSE in the landscape of our national institutions should be one of them.

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, Garten is the author of *The Mind of the C.E.O.* (jeffrey.garten@yale.edu).



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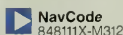
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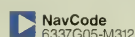
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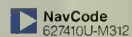
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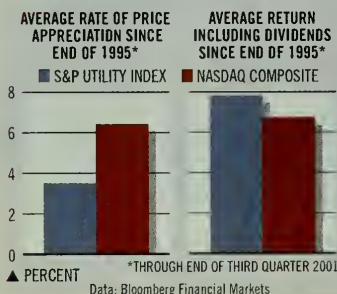
EDITED BY MICHAEL J. MANDEL

UTILITY STOCKS BURN BRIGHT

Over time, their gains top the techs

The tech-laden Nasdaq has always had a reputation of being a place where investors wanting higher returns could put their money—in return for higher risks. Events of the past few years have done nothing to dispel this impression, as many Nasdaq investors made fortunes in the late-'90s boom,

WHY DIVIDENDS MATTER



then lost them in the crash that started in the spring of 2000.

But here's a surprise: The Standard & Poor's Utility index—a sector synonymous with dull—outperformed the Nasdaq Composite index from the end of 1995 through the end of the third quarter of 2001. Including dividends, the utility index showed a 7.8% average return, vs. 6.7% for the Nasdaq (chart).

That figure is no fluke. From the Nasdaq's inception in 1971 through the end of September, the high-tech index has had an 11.2% compound annualized rate of return, compared with 12% for the S&P utilities, according to Richard Bernstein and Lisa Kirschner, quantitative strategists at Merrill Lynch & Co. Utilities won the performance sweepstakes despite incurring less risk.

One reason utilities do so well is that they pay such high dividends—while many tech companies pay little or no dividend. The compounding of a steep dividend yield puts a strong floor under returns. Indeed, over the past two centuries, reinvested dividends have accounted for some 80% of the total return of stocks, after adjusting for inflation, according to data compiled by Wharton School's Jeremy J. Siegel. Thus, since 1995, the price appreciation of the utility index has been only half

that of the Nasdaq, but dividends put utilities soundly ahead.

Market psychology comes in play, too. It's widely accepted that glamorous tech stocks offer the prospect of lush returns over the long haul. The problem is that the more people agree on this, the more money they pour in. That drives up tech prices and reduces long-term returns, argue Bernstein and Kirschner. By contrast, utilities aren't on anyone's list of sensational long-term capital-appreciation candidates. Wall Street ranks utility stocks low in forecasted growth year after year. But utilities' lack of popularity ends up keeping their price relatively low, considering their low risk and high dividends, and offering the possibility of greater capital appreciation later on. On Wall Street, the tortoise can beat the hare.

By Christopher Farrell

OUT OF WORK AND IN THE BAR?

How downturns hit alcohol intake

It is an article of folk wisdom that heavy drinking increases during economic downturns: When people lose their jobs, they turn to alcohol. Yet economists have been somewhat skeptical. For one thing, overall consumption of alcoholic beverages typically doesn't rise much during recession. Moreover, economists argued that falling incomes during a downturn would make it harder for people to boost their purchases of drink.

A new paper by economists Christopher J. Ruhm of the University of North Carolina at Greensboro and William E. Black of Mathematica Policy Research takes a closer look at this seeming paradox. Based on a broad survey of more than 50,000 people each year from 1987 to 1999, they confirm that drinkers do reduce their consumption substantially in recessions. For example, a one-percentage-point increase in unemployment in a state decreased alcohol consumption by drinkers by more than 3%. A one-percentage-point rise in the national unemployment rate amplifies the effect, leading to an even larger reduction in alcohol consumption.

Most of that drop, say Ruhm and Black, occurs among heavy drinkers, the people who spend the most on liquor. That suggests that alcohol abuse is not likely to be an increased problem during recessions. Moreover, the two economists "uncover no evidence that drinking increases among persons be-

coming newly unemployed during bad economic times."

MIDWEST CHILL: NOT SO HARSH

The region may be first to rebound

Well before the terrorist attack the Midwest economy had turned markedly cooler. Its metal-bending manufacturers had slumped into a recession a full year ago, while farmers were getting by thanks only to hefty handouts from the government.

Now, as the rest of the nation begins to shiver, there are tentative signs that the Midwest, which slumped before the rest of the country, may be hit less hard by the latest downturn. On Oct. 30, the Conference Board reported that consumer confidence in October rose in the East North Central region—comprising Illinois, Indiana, Michigan, Ohio, and Wisconsin—while falling in every other part of the country (chart). Meanwhile the region's unemployment rate in September stood at 4.8%, below the national average of 4.9%.

William A. Strauss, senior economist at the Federal Reserve Bank of Chicago, says auto sales have already snapped back due to 0% financing packages. Because the region has less exposure to the computer industry, it may have spared some of the layoffs now bruising the West Coast, he says. And the tourism drought hits the Midwest less hard than other parts of the country.

Still, there are pockets where the ice is thickening. Jobless rates undoubtedly will rise in Chicago. Home-town giants Sears Roebuck, UAL, and McDonald's are all cutting head-office staffs, while the city's convention business is getting whacked by no-shows and cancellations. Chicago, says Diane Swonk, chief economist at Bank One Corp., "is the region's Achilles' heel."

Nevertheless, anyone who has suffered through a Midwest winter knows of course, that a thaw will come soon or later. And this time, it may arrive sooner than in most other regions.

By Michael Arn

MIDWEST CONFIDENCE INCHES UP





And now, for your listening pleasure.

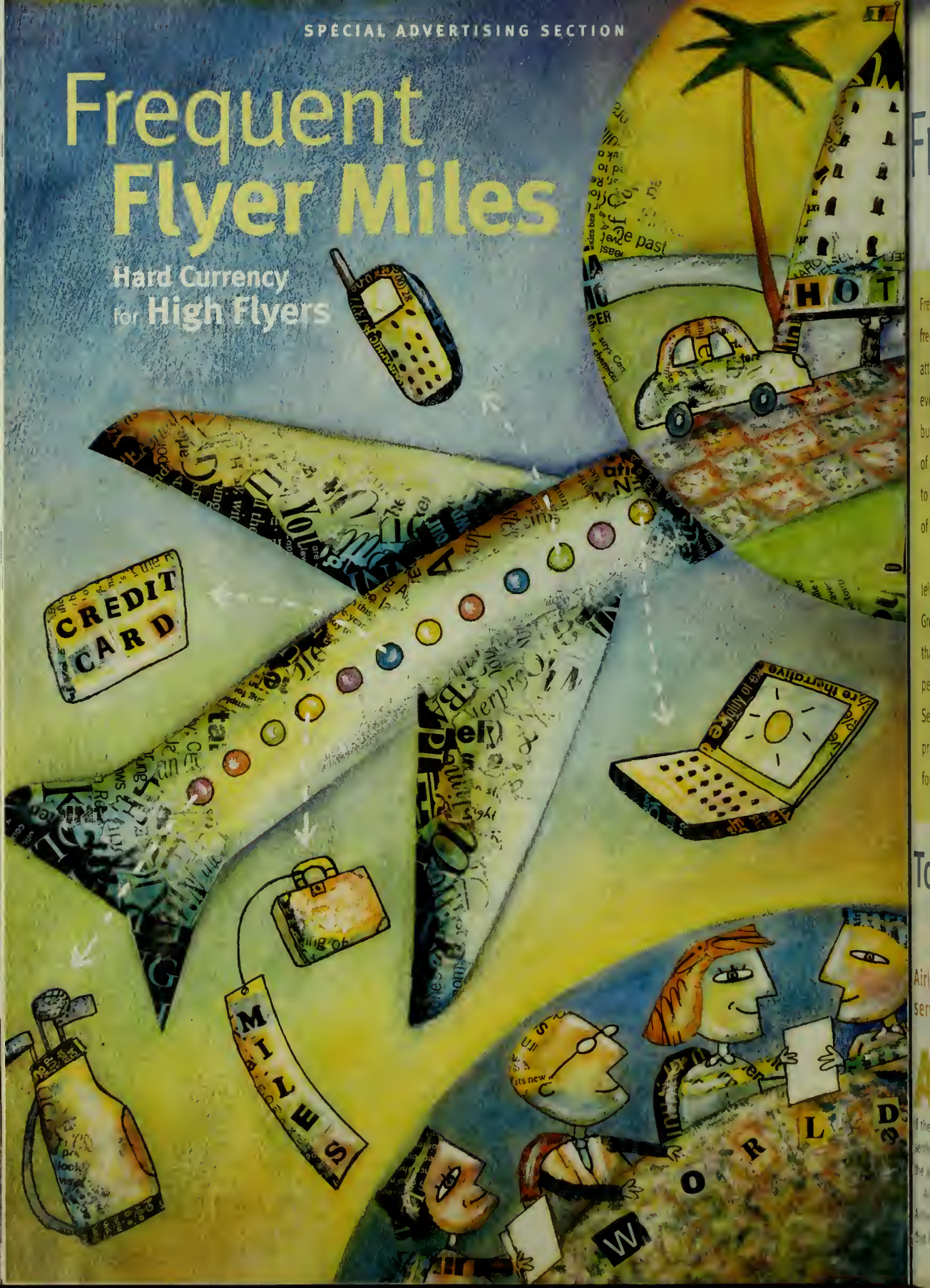
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Miles, Points – and Service Bring Travelers Back

Frequent travelers have been traveling less frequently this year. The tragic September 11 attacks on U.S. airlines and urban targets left everyone wondering about the future. Like other businesses tightening their belts during a time of economic uncertainty, the airlines responded to travel security concerns with significant cuts of their own. (Some even reduced meal service.)

But the simple fact is that for business or leisure, Americans want to travel. One incentive: Great deals. The Air Transport Association reported that average mid-year airfares had dropped 9 percent compared to a year earlier, and after September 11, most major carriers were cutting prices again – on cash fares, or fares redeemed for frequent flyer miles. That should prolong

another trend: Travelers this year have tapped the value in a very visible pot of alternative revenue – airline miles and hotel points.

Even though historically more than 90 percent of hotel points have gone unredeemed, airlines and hotels are reporting a 30 percent rise in redemptions of this hidden currency. For most travelers, that means they'll be returning to travel providers where they have a history. And they have a history not because of miles, but simply because of superior customer service. J.D. Power and Associates, in its most recent study of hotel guests, said the key to loyalty is a matter of degree. Good service is fine, but outstanding performance brings travelers back...again, and again, and again.

Top-tier Service Lures Frequent Flyers

Airlines earn loyalty of customers by offering service that takes bumps out of business travel

All the miles in the world wouldn't make much difference to the frequent business traveler if they didn't translate into customer service. The research says it, and so do the people who fly...and fly...and fly.

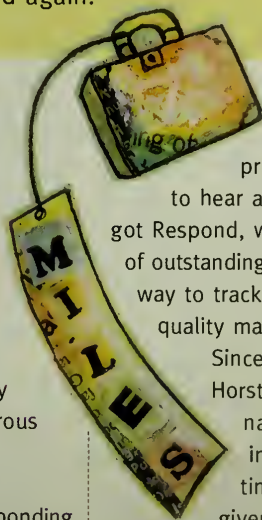
American Express and Southwest Airlines are examples of companies that have approached customers with

service first, earned their loyalty and then rewarded it with generous give-back plans.

To make sure British Airways Holidays was listening – and responding positively to concerns of customers, two years ago the company adopted a system called Respond. British Airways Holidays handles land-based arrange-

ments in connection with air travel. When problems occur, it wants to hear about them. "When we got Respond, we had a high number of outstanding complaints, and no way to track the work load," says quality manager Tania Horst.

Since adopting the system, Horst says, BAH has eliminated duplicate claims, improved its response time by 46 percent, and given employees the tools they need to provide personal service. "Our aim is to go beyond the need that the client has for resolution, and even exceed their expectations," Horst says.



Membership in a miles program is one way for road warriors to define their expectations for an airline. Miles amplify their voices.

For weekly-flyer Kathy Posner, elite membership in the AAdvantage® program of American Airlines adds volume to her voice. Owner and president of Comm2, a public relations firm with offices in Reno and Chicago, Posner says Platinum status pays off – big time. “And I always pay to fly First Class,” she says. “I’ve never used a mile or upgrade. I just want to know I’m getting service.”

Her miles status recently got her luggage push cart past the door of Chicago O’Hare’s Ambassador Club, got an upgrade for her brother on a flight to Rome, and got her direct phone access to the supervisor of flight crews in the Midwest.

As travel providers increasingly migrate sales and “service” to the Web, travelers have grown fearful about being treated less like humans and more like data. To prevent that from happening, Delta Airlines hired Modem Media Inc. to boost customer loyalty by giving customers more access to information, in more ways and from more places. “You communicate in the way customers want it, which makes it more valuable,” says Craig Lambert, Modem Media’s managing director.

From online SkyMiles® statements to wireless check in, from a Palm VII to flight and weather status reports, the goal, Lambert says, is to help Delta “manage the whole customer relationship. When you’ve got people flying every week, it’s so important to make things easier for them.”

Customer service may not do much to ease the underlying causes of flight delays, but it can definitely ease the pain. By knitting their e-ticketing systems together, United and Continental airlines have smoothed the way for passengers booked on both

carriers. The move to interline e-ticketing also means that in the event of a delay or cancellation or need to book alternate travel, someone with an e-ticket on one carrier can easily transfer passage to the other, without having to get a paper ticket.

Earlier this year, 84 percent of members of the National Business Travel Association said they had responded to rising business fares by cutting travel, going to coach class tickets, and booking with low-cost carriers.

Here’s what some airlines are doing to earn your loyalty.

Lufthansa (Miles & More®) **(www.lufthansa-usa.com)**

How would you like to earn 46,212 miles for one round-trip flight? Under Lufthansa’s new double-miles promotion, it’s entirely possible. Fly First Class from New York to Frankfurt, Germany, and back, and the miles are yours. Until Jan. 31, 2002, Miles & More members will earn double the miles they normally would get on all round-trip flights originating in the United States or Canada. Normally, economy fare travelers earn actual miles, business class travelers earn twice the actual miles, and first class flyers earn 300 percent of air miles.

To double those paybacks, program members have to pre-register their flights. Simply call 800-416-5290 and mention the Double Miles Promotion. The deal is available only to Miles & More residents of Canada and the United States, flying only on flights operated by Lufthansa (no code share flights, in other words).

American Airlines **(AAdvantage®)**

Frequent flyers can fight breast cancer and earn 1,000 AAdvantage miles. By sending in at least a \$10 donation and five pink 100-

mile certificates from Kellogg’s Special K and Kellogg’s Smart Start cereals to the Susan G. Komen Breast Cancer Foundation’s Race for the Cure® Series. AAdvantage members can earn the 500 miles plus a 500-mile bonus. More than 15 million cereal boxes carry the certificates.

Malaysia Airlines (Enrich®) **(www.malaysia-airlines.com)**

Tired of trying to conduct business from your assigned seat? Check out the airborne business center on Boeing 777 SuperRanger™ jets of Malaysia Airlines. It’s open to first class, business and Esteemed Traveler tier members of the Enrich program. Leave the laptop at home. Instead, make use of the full multimedia computer, printer, fax and satellite phone in the business center. Malaysia Airlines passengers may also accrue miles with either Northwest WorldPerks® or Delta’s SkyMiles® programs.

Northwest Airlines (WorldPerks®)

Northwest allows travelers using its electronic booking or check in service to change itineraries or confirm new flights. The option is available to any customer holding a full fare or WorldPerks award e-ticket. Changes can be made through phones linked to Sprint PCS Wireless Web, AT&T Digital PocketNet or other Web browser services, PDAs such as Palm Pilots using AvantGo or OmniSky Web browser services, and Internet-ready pagers.



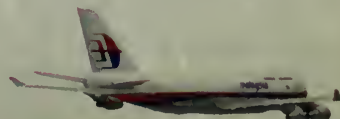


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Great Service

Keeps Guests Pursuing Points

Moving beyond points-based loyalty programs, hotels tailor service to needs of customers



When it comes to the relationship between hotels and their frequent guests, customer loyalty depends on more – more places to stay and earn points, more ways to redeem them, and more value for the points customers pay.

Jeff Diskin, president of Hilton's HHonors® Worldwide, says program members like having an extensive network of hotels from which to choose. More hotels mean more opportunities to rack up points. Diskin says travelers gladly sign up for HHonors when they realize they can pad their points by staying at 2,100 properties affiliated with a host of brands that include Conrad, Doubletree, Homewood Suites, Embassy Suites and Hampton Inns.

A variety of hotel brands give travelers a selection of price ranges and locations from which to choose. That breadth of availability expands the chances that HHonors members will return to hotels affiliated with the program, Diskin says. "A points program doesn't create loyalty. Loyalty is when someone wants to stay with you."

One perk that money can't buy – but definitely comes with repeat business – is personalized customer care. That's

what Wyndham International is trying to do with its ByRequest® program. Working from a central database of information about program members, ByRequest managers at each hotel can customize the guest's room and service. "We're the only hotel chain whose guest program is about instant rewards," says spokesperson Darcie Brossart. "It's not a points-based program."

Amping' up the level of privileges and personal service is key to keeping – and winning back – increasingly fickle customers. So says Michael W. Lowenstein in his new book, "Customer Winback: How to Recapture Lost Customers – and Keep Them Loyal." In an era of shrinking corporate travel budgets, travel providers know that senior corporate executives continue to travel – and spend. At the same time, Lowenstein says, those executives expect a superior product.

To counteract those cost cuts and build brand loyalty, some hoteliers are expanding the opportunities to spend points.

Longtime loyalists with the Marriott Rewards® program, for example, have

turned increasingly this year to their alternate currency. Marriott reports that redemptions for hotel rooms and airline seats have increased by 30 percent this year over last year. In part that's because Marriott has boosted the number of partner airlines from nine to 40 with which Rewards members can redeem points for travel.

Kim Manthei of Marriott says it's also because program members can now redeem Rewards points for blackout-free stays at any of 2,000 participating hotels carrying Marriott brands such as Renaissance®, Courtyard®, Residence® and Fairfield® inns. The blackout-free stays come with a 50 percent payout premium, but it simplifies award travel planning. For more information go to www.marriott.com.

For travelers who want more than another night in a hotel room away from home, the people at Six Continents Hotels – they include InterContinental (www.intercontinental.com), Crowne Plaza, Holiday Inn and Staybridge brands – are serving up...tools. After asking members of its Priority Club what they wanted, Six Continents worked out the means for people to spend points with Home Depot, Best Buy and Target.

And if you can't find what you want there, they'll hook you up with one of their personal shoppers. Call a toll-free number, tell them what you want, and they'll find, order and price the product (in points) for you. "It's a total shift of focus," says Pamela Mulder, director of consumer marketing for Six Continents. "It's not letting the program dictate what customers get for their points. It's saying, 'You stay with us, give us your loyalty, and we'll give you points that are as good as cash.'"

Until now, the only time you got three wishes was in a fairy tale.

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Web Sites Lure Travelers With Miles Tools

Based on the premise that Web travelers spend too much time searching different sites for key information – miles account status, comparative airfares, mapping – Retrieve-It Inc. is building tools to do the Web-walking for you. Harris Turner, founder and chief executive, says Retrieve-It's first release is a stripped down application called MilePro. After downloading the current release (for Windows only), the user keys in PINs and other personal data, which remains on the user's computer.

Then the user asks for information, the software reaches out, scans the targeted Web sites, and retrieves details about miles programs from 17 U.S. airlines, British Airways, all major hotel groups and assorted shopping sites. "People want to go to the Internet, gather information, and get off," Turner says. "The whole concept is saving time – and lots of it."

Helping travelers save time and money on hotel bookings, Quikbook.com also tries to help hotels fill rooms that might otherwise go empty. Ray Vastola, president and founder, says it's the same idea as weekend Web airfare specials, applied to lodging. By actively learning more about its customers, Vastola says Quikbook.com can simplify the reservation process by serving up only the hotels that travelers might actually be interested in.

Here's something for your business travel needs.

Cingular Wireless (www.mywirelesswindow.com)

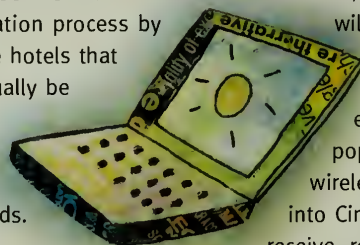
Users of Web-enabled wireless phones on the second largest carrier in the U.S. now have access to weather information for up to three cities. All they do is register at www.weather.com,

receive an ID number, enter it into the phone, and get weather information through the My Wireless Window portal.

Tired of trying to access corporate e-mail from the road? Eager for discreet communication at times when cell phones would be intrusive? Cingular has a solution – Corporate E-Mail PLUS.

For \$44.99 a month, Cingular will link users of the BlackBerry wireless e-mail system to their office e-mail. Owners of the popular RIM 950 and 957 wireless handhelds can tap into Cingular's network to receive, respond to and forward office e-mail – plus send text messages and Internet e-mail. To learn more or order, go to www.cingularinteractive.com or call 888-825-2727.

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Turn Miles, Points into Cash for Disaster Relief

If you're a member of a miles or points program and would like to contribute some or all of your account toward September 11 relief efforts, here's a quick look at how you can do that through some of the major loyalty programs.

If you don't see your program here, it doesn't mean you can't donate those miles or points. Up until we went to press, the situation was changing daily. As always, it's best to check with the program itself.

- **Delta Airlines:** SkyMiles® members may donate through Delta's SkyWish program. To donate at least 5,000 miles, send e-mail to delta.bids@delta.com, call 800-325-3999, fax at 404-773-1945, or inquire at any Crown Room Club location.
- **United Airlines:** To inquire about options for donating at least 1,000 MileagePlus® miles, go online to www.ual.com or call 800-421-4655.
- **US Airways:** Members of the Dividend Miles® program can donate 5,000 or more miles by going online at www.usairways.com or calling 800-872-4738.
- **Continental:** Donate OnePass® miles by going online at www.onepass.continental.com, log in to your account management page, then click "Donate Your Miles." Or simply call 713-952-1630.
- **Northwest:** To donate miles from your WorldPerks® account, call 800-327-2881.
- **Starwood Hotels:** Members of the Preferred Guest® program can help the families of victims and relief workers by donating Starpoints to the September 11th Fund. Call 877-782-0118 or go online to www.spg.com.
- **Six Continents (Inter-Continental, Crowne Plaza, Holiday Inn and Staybridge Suites):** Members of the Priority Club Worldwide® frequent guest program may donate points in blocks of 2,500. Priority Club will match each donation. Call 800-447-3418.
- **Hilton Hotels:** Members of the HHonors® program will earn a \$25 matching contribution from Hilton for each block of 10,000 HHonors points they donate. To donate, call 800-548-8690.



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A STAR ALLIANCE MEMBER

DESPITE SCARY DATA, THE RECESSION COULD BE MILD

better inventory control and falling imports will help soften the blow

U.S. ECONOMY

The tenth U.S. recession since World War II is starting to leave its mark. But despite some horrendous-looking data of late, especially from the labor markets, there is still every reason to believe that the downturn will be mild by historical standards.

Certainly, timely and aggressive policy moves will cushion the downturn, but they are only part of the story. Businesses had made extensive adjustments to the slowdown in demand prior to the events of September 11. Much of the heavy lifting had already been done, helping to make the economy less vulnerable to the shock. The Commerce Dept. reported that third-quarter real gross domestic product declined at a mere 0.4% annual rate. Had the terrorist attacks not occurred, growth could have been well into positive territory, and analysts would now be focused on recovery, not recession.

Technology and globalization also have given the economy some potent shock absorbers. First, more efficient inventory-management systems have already drastically reduced excess stockpiles. The \$50.4 billion rate of liquidation in the third quarter was even faster than it was in the second quarter, making the total liquidation of the past three

quarters the largest in postwar history (chart). In coming quarters, a slower pace of liquidation will add to economic growth. And because tighter security has slowed distribution this quarter, many businesses are relying on precautionary supplies in excess of what they could normally hold.

Moreover, imports are now so much larger than exports that a falloff in U.S. demand will actually narrow the trade deficit. Last quarter's GDP numbers show that exports dropped by a sharp 16.6%, but imports increased 15.2%, resulting in a narrower trade gap that added to the quarter's GDP growth. Tighter border security is sure to slow import growth even more in coming months, although lower imports will worsen downturns in economies around the world.

FOR NOW, THE RECESSION looks anything but mild, and fourth-quarter real GDP is set to fall at a faster rate than it did in the third. The economic data

coming in are some of the first post-September 11 readings, and they reflect the initial shock effects on consumer and business activity. The numbers prove that households and companies did exactly as expected when a crisis hits: They froze. Retail buying and factory orders for new equipment fell off a cliff. Consequently, profits plummeted, and job losses soared. The flurry of bleak news is why economists expect the Federal Reserve to cut interest rates for the tenth time this year when policymakers meet on Nov. 6.

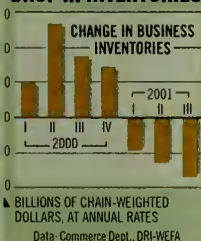
However, the true weakness in the economy is not as bad as these alarming September and October data suggest. Businesses are rattled right now, but as they get a better handle on current and future demand, their ordering and hiring rates will come out of the deep freeze.

Prior to September 11, companies had made enormous progress toward cutting their labor costs and maintaining productivity gains. Employment costs for the year ended in September were up 3.9%, lower than their 4.7% pace of a year earlier. Moreover, the GDP data suggest that productivity in the third quarter posted a solid advance, because businesses cut hours worked much more rapidly than output fell.

Businesses have been realigning their inventories and capital spending all year to match up with diminished prospects for demand. Then, in September, orders for new capital equipment plunged 11.4% (chart). Shipments, which tumbled 3.2%, were far below their third-quarter average, meaning that capital spending in the fourth quarter is already in a deep hole. Business outlays for new equipment and construction fell 11.9% in the third quarter, and they will likely post another double-digit decline this quarter.

CONSUMERS also are still shaken up. They are obviously concerned about the war, both at home and abroad, but their biggest worry on the economic front is jobs. Consumer confidence fell sharply in October for the second month in a row. Household expectations of future conditions worsened, but consumers also noted that present conditions are deteriorating rapidly. Importantly, the share of households who say jobs are

AN UNPRECEDENTED DROP IN INVENTORIES



CAPITAL SPENDING DRIES UP



Business Outlook

hard to get jumped to 20.7% last month, the most in almost five years (chart).

Keep in mind that consumers hold the key to the severity of this downturn. The September plunge in retail buying limited consumer spending to a gain of only 1.2% in the third quarter, the slowest pace in eight years, and fourth-quarter outlays will likely decline. However, not all household news is bad. Confidence is down, but it remains well above the lows plumbed in past recessions. Also, consumer buying, particularly for motor vehicles, rebounded somewhat in October—perhaps out of a sense of patriotism, perhaps as a result of 0% financing.

THE PROBLEM IS that recent reports are only fueling consumers' job jitters. In September, the Conference Board's index of help-wanted advertising in newspapers around the U.S. fell to the lowest level since the severe 1981-82 recession, although this index may have been pushed down in recent years by increased Internet job listings. Through October, the four-week average of new claims for unemployment benefits edged above 500,000 per week, matching the peak hit during the mild 1990-91 recession. Still, during the 1981-82 downturn, claims topped out at 674,000.

The claims numbers are a good example of how the data have deteriorated after the attacks. The next few weeks will bring equally disastrous news on more lay-

offs, industrial production, and factory orders. However, as the initial impact of September 11 wanes, the data will not look as dire as they will in the days just ahead.

Until September 11, the weakness in the job markets and in the economy generally was not sufficiently severe or broad to qualify as a recession, and the building blocks of a recovery were falling into place. Now, the National Bureau of Economic Research, the official arbiter of business cycles, will most likely take into account that past weakness when it sits down to determine when this recession began. That means the start date of the downturn is likely to be set much earlier this year.

Recessions eventually do end. Already, the economy is benefiting from the aggressive policy in place prior to September 11. Lower interest rates and tax rebates are helping businesses and consumers shore up their finances, and that reliquefaction will pave the way for stronger demand later on. Add to that the structural advantages of better inventory management and open trade. These shock absorbers will smooth some of the bumps ahead, and they will play a significant role in ameliorating the pain of this downturn.

JOB JITTERS DARKEN THE CONSUMER'S MOOD



BRITAIN

DECENT GROWTH—BUT CAN IT LAST?

Amid the talk of global recession, Britain posted some upbeat news: Its third-quarter real gross domestic product surpassed expectations. But can a diligent central bank and healthy service sector keep Britain out of recession?

Britain's real GDP rose by 0.6% in the third quarter from the second, better than the 0.4% forecast by most analysts. Consumer purchases continued to lead growth, while the manufacturing sector remained in recession.

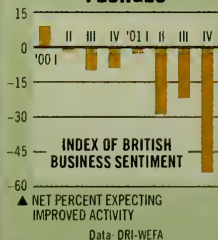
Real GDP is now up 2.3% from a year ago, making it very likely that Britain will grow more than 2% for all of 2001. If so, the nation will lead all Group of Seven countries in economic growth for

this year. Consumers should keep spending this quarter as job markets remain fairly tight.

But consumers are worried about the economy over the next year—and for good reason. First, some of the consumer-spending strength reflects gains in tourism. That sector's outlook is dimming because of jitters over air travel and some rise in the pound sterling. Second, the Confederation of British Industry's index of business confidence plunged,

from a reading of -22 in the third quarter to -54 in the fourth (chart). Because of the slowdown in Europe and the U.S. recession, the index for export expectations fell to a 21-year low.

BUSINESS OPTIMISM PLUNGES



Pessimism is growing despite six interest-rate cuts by the Bank of England's Monetary Policy Committee, including quarter-point cuts on Sept. 18 and on Oct. 4. Analysts expect another quarter-point cut on Nov. 8.

For now, the BOE has decided to shift its concern toward the global economy and away from British inflation. Consumer prices increased just 1.7% in the year ended in September, and prices excluding mortgage interest were up only 2.3%. Governor Eddie George, however, has made it clear that, once the global downturn passes, the BOE will quickly return to inflation-fighting. That means the bank may be quite accommodative in the next few months, but it could reverse its policy course rapidly late in the first half of 2002.



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BILL TAKES THE WHEEL

Ford's new CEO is well-liked, but can he bring off the needed overhaul?

For a brief, shining moment on the morning of Oct. 30, Ford Motor Co.'s Dearborn (Mich.) headquarters felt like Camelot. Cheering workers surged to their feet as William C. Ford Jr. introduced himself as the company's new chief executive officer at a hastily arranged press conference. Amid the gloom about worsening profits and quality, the ouster of CEO Jacques A. Nasser at the hands of founder Henry Ford's well-liked great-grandson was a tonic to battered morale. And the shift in mood was almost palpable. "It was like the old Ford again," says one company insider. "People were smiling again instead of staring at the ground."

Trouble is, it's not the old Ford. The company, hailed by Wall Street just last year as the best-managed of the Big Three, is in a tailspin. Its stock has tumbled 58% since May, 1999, its 10-year high. And it has slipped 32% this year—about twice as far as General Motors Corp. or DaimlerChrysler. The company lost more than \$1.4 billion in the past two quarters, thanks to soaring costs, falling prices, big rebates, and the Firestone tire recall. With the popularity of such mainstay models as the F-150 pickups and the Explorer SUV waning, Ford has surrendered 1.5 points

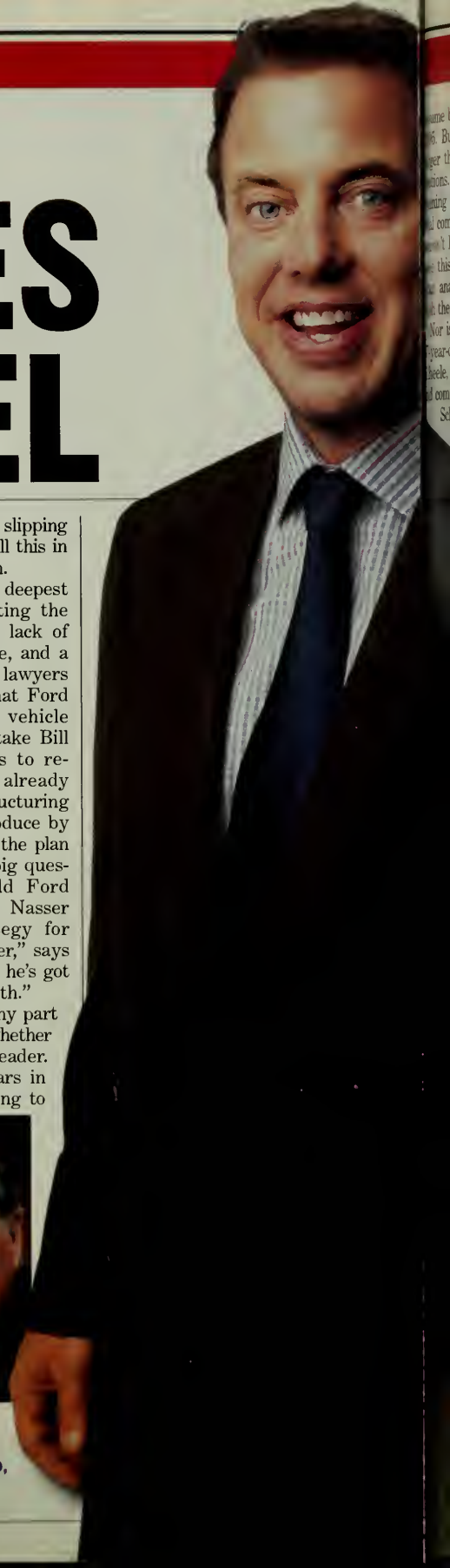
of market share this year alone, slipping to 22.8% of U.S. vehicle sales. All this in an economy that's heading south.

Toughest of all will be Ford's deepest problems—quality snafus, putting the Firestone debacle behind it, a lack of exciting vehicles in the pipeline, and a brain drain. Indeed, on Oct. 31, lawyers for Explorer owners alleged that Ford withheld knowledge that the vehicle was unstable. At best, it will take Bill Ford and his new team years to reverse the damage. They are already hammering out a broad restructuring plan that Ford promises to produce by early January. Whatever shape the plan takes, it will have to tackle a big question about the future: Should Ford shrink to become stronger, as Nasser argued, or plot a new strategy for growth? "Bill is the right leader," says one former Ford manager. "But he's got a crippled company to work with."

NO DREAM. The crippled company part is surely true. Far less clear is whether Bill Ford is really the right leader. The new CEO did spend 15 years in Ford management, before leaving to



READY WITH THE WRENCHES
CHIEF OPERATING OFFICER SCHEELE, 57, AND NEW VICE-CHAIRMAN REICHARDT, 70, WILL DO THE NUTS-AND-BOLTS WORK IN SORTING OUT THE MESS



assume broader board responsibilities in 1995. But he has never run anything larger than Ford's minuscule Swiss operations. No one pretends he would be running the world's fourth-largest industrial company at age 44 if his last name weren't Ford. And no one on Wall Street sees this as a dream team. Shrugs veteran analyst Maryann Keller: "You go with the best you've got."

Nor is it clear whether Ford's No. 2, 47-year-old Chief Operating Officer Nick Scheele, has what it takes to fix so large and complex a mess. Just two years ago,

Scheele was running Ford's prestigious but tiny Jaguar unit.

He has since leapfrogged through two big jobs, before be-

coming head of operations on Oct. 30. Meantime, board member Carl E. Reichardt, 70, the retired chairman of Wells Fargo & Co., who as new vice-chairman will oversee Ford's finances, is taking on a huge task. The job, he jokes, is akin to "a 45-year-old quarterback being asked to strap on the pads again."

EASY MANNERS. But don't write off this unlikely crew quite so fast. Any one of them on his own wouldn't be able to run the company. But Ford and team, among them, possess an impressive array of skills the carmaker will need. Bill Ford is no lightweight: He's a quick study who has run auto operations from climate control to commercial trucks and has had stints in sales, manufacturing, and labor relations. For six years, he headed the board's powerful finance committee. What's more, Ford enjoys a strong bond



JUNE 25, 2001

with the rank and file—at a company that prizes its ties to the Ford family. Ford's dealers, who bear the brunt of quality woes, also seem to have a soft spot for the new CEO. "You can't get mad at Bill Ford," says Lincoln-Mercury dealer Martin J. "Hoot" McInerney. "He's just too nice a guy."

Bill Ford's two henchmen bring their own assets. Scheele earned his stripes

turning around Ford's quality-plagued Jaguar division in the 1990s. In early 2000, the 35-year Ford veteran took on the company's perennially troubled European operations, launching a \$1 billion restructuring that slashed output by 17% and launched snazzy new products. The unit is expected to turn a profit in 2002. In just three months, Scheele has won a solid following among Ford's North American ranks for his candor and popular "back to basics" mantra that puts the focus squarely on making and selling cars and trucks. Signing on Reichardt, a top banker favored by investing whiz Warren E. Buffett, wowed Wall Street and gives Ford much-needed financial acumen. "It's a stroke of genius," says Keller.

Running Ford Motor is hardly a one-man job, as the new CEO hastens to point out. "I expect the three of us will

have an easygoing partnership," he adds. That would be a big improvement over his strained power-sharing arrangement with Nasser, a talented but autocratic manager who hated to delegate and tried to

keep his boss out of the loop. This time, Bill Ford has handpicked his team, choosing managers known for their willingness to be team players.

Indeed, just the absence of Nasser makes Bill Ford's job easier. The ex-CEO's willingness to squeeze suppliers, upset dealers, and shed experienced employees as he rushed to remake Ford as a consumer company made him a lightning rod. Several top Nasser confidants have also already gotten the ax, and others may follow. Ford really needed to see a new team to lead [it] out of the wilderness," says David E. Cole, director of the Center for Automotive Research in Ann Arbor, Mich.

The hard part is yet to come. The restructuring plan is expected to trim

BILL FORD'S JOB LIST

RESTORE MORALE

He must boost spirits of Ford's unhappy salaried workforce—and rebuild relations with unions, dealers, suppliers, and investors.

IMPROVE QUALITY

Among the big carmakers, Ford now ranks lowest in terms of quality. That has caused delays in the launch of products such as the T-Bird and has led to embarrassing recalls on its new Escape and Focus models.



STRENGTHEN THE LINEUP

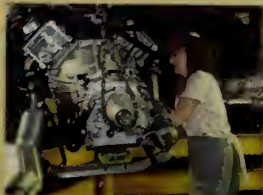


Longtime best-sellers such as the F-150 pickup series and the Explorer are fading. Ford needs fresh product to regain market share, raise revenues,

and reduce the need for costly marketing incentives.

CUT COSTS

To restore short-term profits, Ford will have to sell assets, squeeze suppliers, trim its workforce, and idle excess capacity. Eventually, Ford also needs to design lower-cost vehicles.



away \$3 billion to \$5 billion in costs. Shrinking the company to match its diminished market share would be the quickest way to repair Ford's finances. But insiders say Bill Ford will be less likely than Nasser to favor downsizing the company. Nor has the new team yet spelled out how it will deal with nagging problems such as quality. Last-minute glitches have delayed the launches of a series of products, most recently the eagerly awaited new Ford Thunderbird. But the choice of manufacturing boss James Padilla to replace Scheele as head of North America is seen as a step to bolster quality.

HAMSTRUNG. It will also be tough to get crowd-pleasing new cars and trucks into showrooms on a shoestring. Scheele says Ford has locked in future product plans, but insiders concede what's in the pipeline isn't exciting enough to rebuild sales. Scheele says he would like to add more car-based SUVs and other innovative crossover vehicles to the lineup, but that will

take years. So will rebuilding Ford's depleted talent bank.

The most immediate challenge will be eliminating the cost of excess factory capacity. Analysts believe that Ford needs to close at least two or three assembly plants to stop its hemorrhaging. But the company is hamstrung by its 1999 contract with the United Auto Workers, in which Ford agrees not to close or sell any plants. "The contract's in cement," says UAW President Stephen P. Yokich. Still, Chrysler and the UAW worked together to devise a plan that eliminates work shifts and slows assembly line speeds at North American factories to cut output and minimize job losses. And with the good will that comes with his popularity and name, Bill Ford might be able to find some wiggle room to hatch a similar deal.

Where else could Ford economize? Analysts also suggest Ford might find it easier to unload some of the "downstream" auto-related ventures Nasser acquired now that he's gone: the British repair chain, Kwik-Fit; a junkyard business in Florida; and a slew of small e-business startups the company financed. Bill Ford will only say "Everything is up for review—every asset, every piece of geography. We'll continue to review our mix of businesses."

Such cuts, no doubt, would provide the quickest path back to the basics, and that's exactly where the new team wants to take Ford. "It's not the Internet, junk yards, or auto parts," says Cole. "It's building cars and trucks." Now there's a novel idea.

By Kathleen Kerwin and Joann Muller in Detroit

Ford has given up hope of getting the union to accept plant closures

A RUSH FOR THE UAW DRIVER'S SEAT

The job of championing auto workers during the coming hard times is about to fall to a new man. As Stephen P. Yokich, 66, gets closer to stepping down next June from his post as president of the United Auto Workers, two UAW veterans are vying for his position. Ronald Gettelfinger, 57, considered to have the inside track, is the UAW's vice-president in charge of members at Ford Motor Co. Richard Shoemaker, 61, is his counterpart at General Motors Corp. On Nov. 8, leaders of the union's dominant party will choose one as its nominee for election next June.

Whoever gets the nod will be following a controversial leader who leaves with a mixed record. Yokich, president since 1995, gets credit for preserving wages, benefits, and pensions of UAW workers and retirees. He has been less successful at reversing the slide in membership, now less than half its 1978 peak of 1.5 million. Yokich has also failed to organize workers at foreign-owned plants in the U.S. A drive to organize 4,000 Nissan Motor Co. workers in Tennessee last month failed by a wide margin.

THE PLEDGE YOKICH, FORD, PESTILLO—AND GETTELFINGER, WHO IS FAVORED TO TAKE OVER YOKICH'S POST AT THE UNION



Will the new guy do better? Gettelfinger, for one, has proved he can be a tough adversary. He earned high praise inside the union for hardball tactics that won a generous contract at Ford. Gettelfinger also backed Ford's then-chief negotiator, Peter J. Pestillo, into a corner by threatening a national strike over the spin-off of parts-maker Visteon. In the end, Ford was forced to retain existing Visteon workers on its payroll for life, even after the spin-off. He's known as abrasive yet politically astute, with broad support among the UAW's 12 regions nationwide.

Shoemaker, soft-spoken and thoughtful, has close ties to Yokich as his loyal and longtime assistant. But he hasn't always been as effective as Gettelfinger. Critics point to his role in leading workers on 13 strikes at GM since 1996, including two devastating walkouts in 1998 that shut down the company and cost the auto maker \$2 billion.

UAW leaders also give Shoemaker demerits for allowing GM to shift too many jobs to lower-paying suppliers. And when GM spun off its own parts unit, Delphi Automotive Systems, Shoemaker failed to win a Visteon-type contract for its workers. That's why the smart UAW money is betting on Gettelfinger.

By Joann Muller in Detroit

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THE WAR ON TERRORISM



A BURST OF FRIENDLY FIRE

Second-guessing on the conduct of the campaign has already begun despite early successes

As the U.S. campaign against Osama bin Laden enters its second month, neither the stealthy sheik nor his Taliban protectors have yet to suffer a decisive setback on the battlefield. Meantime, nonstop bombing raids are causing civilian casualties and turning even more of war-scarred Afghanistan into a lunar landscape. The predictable result: Alliance nerves are beginning to fray amid the first signs of doubt about the Bush Administration's conduct of the war.

George W. Bush himself seems immune to the second-guessing. Buoyed by a confident performance under fire and a surge of patriotism, the President is hugely popular. In an Oct. 25-28 CBS News-New York Times poll, he garnered an 87% approval rating, and nearly 90% of Americans backed the war.

Although Bush has soared in stature as he has plunged into his new mission against global terror, it's open season on his War Cabinet. Most skeptics are homing in on what looks like a halting drive to beef up domestic defenses against terrorists. But as the U.S. con-

tinues its emphasis on air strikes in Afghanistan, questions are also being raised about American military strategy.

Indeed, the White House now faces a crossfire of criticism spanning both ends of the political spectrum. GOP hawks, such as conservative Arizona Senator John McCain, fret that the State Dept.'s desire for a broad anti-terror coalition is sending the U.S. military into action with one arm tied behind its back. McCain advocates a massive troop deployment to finish a job that antiseptic bombing alone can't accomplish.

Doves, meanwhile, fear a Vietnam-style quagmire. "I'm not sure bombing helps us capture bin Laden [because] it makes it harder to maintain the alliance," says William D. Hartung of the liberal World Policy Institute. "We need more emphasis on diplomacy."

Knees are buckling by coalition members, too. Pakistan and Egypt warn that lengthy bombing will spur radicalism in the Muslim world—though evidence thus far suggests that government crackdowns have suppressed the most violent forms of street protests.

In Europe, the call for a bombing halt has also been taken up by Greens and social liberals, including some members of Britain's Labor Party. The anti-

war Left insists that the rising civilian toll renders Bush's mission morally indefensible. For support, protesters point to a new poll by NOP Research Group in London that finds 53% of Britons oppose bombing of military targets in Afghan towns and cities.

This back-bench dissent seems wildly premature at the start of such complex conflict, particularly since the U.S. has racked up its share of early successes. Among them: creation of a far-flung alliance to pursue terrorists and their financial angels; speedily moving troops and hardware to the outskirts of Afghanistan; and taking out Taliban supply routes and communications facilities. Says Anthony H. Cordesman, an analyst at the Center for Strategic & International Studies: "We're seeing good execution of an uncertain plan."

But the Administration has brought some problems on itself. How? By following up the President's initial warnings of a long war with rosy pronouncements about the Taliban supposedly shaky morale; by letting the CIA take the rap for a bit of Keystone Kops skulduggery that saw Pashtu commander Abdul Haq get killed on a mission inside Afghanistan; and by al-

CONFUSION The Administration has sent mixed

WHAT'S BEEN ACCOMPLISHED, WHAT'S NEXT...

PHASE ONE OBJECTIVES

- Knock out the Taliban's air defenses, tanks, weapons caches, and fuel depots so that its ability to fight a long war is degraded. **Done.**
- Bomb dug-in Taliban positions on the northern lines to keep fighters pinned down and weaken morale. **Done.**
- Disrupt Al Qaeda's command-and-control system. **Unfinished.**



BUSH: No dent in his popularity

PHASE TWO OBJECTIVES

- Begin the ground war. **The catch:** The Alliance incurs the first significant casualties of the war.
- Go after bin Laden. **The catch:** Winter vastly complicates the cave-by-cave search by U.S. and British Special Forces. And commandos are likely to face heavy losses.

PHASE THREE OBJECTIVES

- Replace the Taliban. **The catch:** Any new government's reign could prove short-lived, as tribal and regional rivalries flare up.
- Shut down Al Qaeda. **The catch:** A neutralized bin Laden is elevated to hero status throughout the radical Islamic world; and the U.S. faces pressure to go after other terrorist-friendly regimes, from Iraq to Sudan.

Data: BusinessWeek

The aim is to secure enclaves from which to launch waves of helicopter missions, backed by allied jets providing close-air support. Once an airfield or other critical asset is captured, analysts say, regular troops would come in. But Phase Two will inevitably mean U.S. and British casualties. Moreover, the secure-enclave idea bears an unnerving likeness to Vietnam's "strategic hamlet" plan, which failed miserably in shielding U.S. forces from guerrillas.

■ **Winter Soldiers.** Hopeful that winter may rule out a big U.S. ground sweep, Taliban fighters will hunker down. The U.S. will try to take advantage of the lull by attacking supply lines and sending B-52s to pound fixed positions. But bombers are not effective against caves—the favored hiding

ernately depicting Northern Alliance rebels as a formidable fighters and not-a-dy-for-prime-time insurgents.

Then there was a final bit of confusion: State Dept. officials first hinted that the U.S. would cease hostilities during the month-long Ramadan observance. But national security officials worried that the pause, followed by the onset of winter, would sideline bin Laden's pursuers until spring. On Oct. 1, Defense Secretary Donald H. Rumsfeld insisted operations would proceed.

In fairness to a White House that once thought its fiercest face-off would be against welfare-state liberals, it's never easy shifting gears to a war strategy—especially one that envisions battles both at home and abroad. So it shouldn't come as a surprise that the campaign has been characterized by improvisation and miscues. "Things are proceeding according to plan—but plans are tailored on a daily basis to intelligence coming in," says retired Rear Admiral Stephen H. Baker of the Center for Defense Information, a Washington think tank.

Although distracted by a domestic anarax attack and the prospect of more error strikes in the U.S., the White House is slowly shaping a military strat-

egy that fleshes out the President's initial vision of a 21st century conflict. The prospect: years of struggle against terror networks in Afghanistan and other haven countries. What skeptics have seen thus far is just Phase One of the war. Here's an assessment of where the battle stands and where it could go next:

■ **Round One.** Air strikes have disrupted Taliban communications and wiped out many anti-aircraft missiles, fuel depots, and arms caches. Now, bombers are targeting tanks and front-line troops to prepare for a Northern Alliance offensive. The not-so-good news is that many Taliban fighters are hiding in cities. Meantime, civilian casualties stoke sympathy for the regime. The ill-equipped Northern Alliance, which is still awaiting Russian arms, has been slow to capitalize on the bombing.

■ **Mano a Mano.** The inability of air power to cleanse the battlefield means that, inevitably, ground forces will be required. Thousands of U.S. and British troops will launch search-and-destroy operations soon. Some attacks could be launched from a base in Khanabad, a site in Uzbekistan. Sources say 60 U.S. helicopters have been ferried in to Khanabad, which is a short hop from Afghanistan's northern border.

place of the *mujahideen*. Also, some military experts are doubtful about air power. Says Pentagon tactical-air expert Franklin C. Spinney: "We're waging a standard battle against an adversary who has no infrastructure."

As the allied campaign stretches into next year, strains on the coalition will grow. Pakistan, Egypt, and Saudi Arabia warn that the establishment of U.S. ground bases and allied moves against cities such as Kabul could cause them to rethink their backing of the war. "The longer bombing goes on, the greater will be the support for Taliban," says Abdul Rahim Hashmi, cousin of fallen Pashtun leader Abdul Haq.

In the end, all of the basing rights, intelligence-sharing deals, money crack-downs, and vows of coalition support cannot change the reality for George Bush: He has been forced to undertake a long and arduous mission—one that could take years to unfold—against a fanatical foe. That means the voices of dissent Bush is hearing now are just whispers compared with the noisy protests that await down the road.

By Lee Walczak, Stan Crock, and Paul Magnusson in Washington, with Frederik Balfour in Islamabad, Susan Postlewaite in Cairo, and bureau reports

als on the length of the conflict and the abilities of the Northern Alliance



FERTILIZER: One of Fauji's cash cows

PAKISTAN

ARMED FORCES INC.

Pakistan's military dominates the nation's economy

It's early morning in Islamabad, and a middle-class child sits down for breakfast. He pours sugar refined from Fauji Sugar Mills into a bowl of Fauji oatmeal, which his mother cooked using gas bottled by Fauji LPG. In the next room, his father logs onto a computer run on electricity produced by the Fauji Kabirwala power plant and clicks onto a program that uses Fauji software. The house they all live in was, of course, built with Fauji cement. The Fauji group is a pervasive commercial presence in Pakistan. And the Fauji Foundation that the companies are all part of is closely linked to an even more ubiquitous institution—the Pakistani military.

As Western policymakers try to figure out how to help the economy of Pakistan, their reluctant ally in the war against terrorism, the issue of the military's role in the economy could turn out to be divisive. The military's heavy influence on business has hampered development of companies that might compete with military enterprises. It also gives the generals a huge stake in maintaining the status quo—though the economy has lurched from crisis to crisis. "The clout of the army makes it more influential than any other corporate body in terms of influencing nonmilitary decisions," says Tariq Rehman, a professor

of South Asian Studies at Quaid-i-Azam University in Islamabad. "It impedes the development of a civil society."

The Fauji Foundation is at the heart of the military's economic machine. With annual turnover of more than \$500 million and profits of \$41 million, Fauji provides womb-to-tomb benefits for more than 8.5 million ex-military men and their dependents. Retired servicemen get preferential hiring for the 10,000 jobs at the foundation's companies. Thousands more find work at Fauji subsidiaries, while top management jobs are reserved for retired generals.

BIG PLAYER. And Fauji represents just part of the military's business operation. The army, navy, and air force operate their own corporate foundations. Beyond that, the Defense Ministry pours public money into its own lucrative businesses, which engage in such pursuits as road

GUNS AND CORNFLAKES

Pakistan's armed forces reach into many sectors of the business world



MILITARY-AFFILIATED FOUNDATIONS

FAUJI FOUNDATION

Fertilizers, power generation, breakfast cereals, sugar mills, natural gas

ARMY WELFARE TRUST

Banking, insurance, real estate, cement, pharmaceuticals, shoes

SHAHEEN FOUNDATION

Air cargo, TV broadcasting, real estate, knitwear

bank. Military companies enjoy access to prime real estate, easy bank credit, and tax breaks, and routinely beat out civilian companies in bidding for contracts.

Foundation Secretary retired brigadier Mumtaz Hussain denies that his group has any special privileges. "The environment is ruthlessly competitive," he says. "If we offer better deals, we win. If we can't, we are nowhere."

But many Fauji offshoots are in deep trouble. Because of massive overcapacity in the cement industry and crippling debt, Fauji Cement Co. has lost \$23 million since it began operations in late 1997. Another dog is Fauji Jordan Fertilizer Co., funded in part by the Export-Import Bank of the U.S. The Fauji Foundation has had to inject cash to keep the company afloat.

Nonetheless, the military foundation and other army-connected companies are above reproach. "If you criticize the armed forces, you are committing treason," says Rifaat Hussain, chairman of defense & strategic studies at Quaid-i-Azam University. Less reticent are some ex-military men. Speaking of some business debacles at the AWT, former Interior Minister and retired general Nasirullah Khan Babar says

CEREAL: "There should be accountability. But because [managers] are protected by the army there are no checks."

Nonmilitary critics worry that the system, which also provides free health care and top-ranked schools to ex-military, perpetuates a big gap between the military haves and the civilian have-nots. "It's a flaw in the system," says Hussain. "It doesn't operate on the principle of equal opportunity and access." And Pakistan won't either until it stops tilting the playing field to favor the military.

By Frederik Balfour in Islamabad



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THE ECONOMY

UP A CREEK— WITH LOTS OF CASH

Many U.S. companies are managing to stay liquid despite sickening drops in net earnings

There's hardly a company more vulnerable to the tech-led downturn than Texas Instruments, the Dallas maker of chips for cell phones and other gear. Its net sales fell more than 40% in the third quarter from a year earlier, and it lost nearly \$120 million, after raking in profits of almost \$680 million the previous year.

But Texas Instruments Inc. didn't get to be 71 years old without knowing how to weather hard times. To preserve its all-important cash, TI has cut capital spending by two-thirds from a year ago. It has laid off 6% of its employees and trimmed inventories to 58 days' worth of sales, vs. the 71 days' worth it held late last year. Because it ties employees' pay to its financial performance, it will save hundreds of millions in profit-sharing expenses due to faltering results.

As a result, TI is hardly pressed to the wall. It has \$3 billion in cash and marketable securities, even more than during its boom years. It's certain enough of its finances that it continues to pay \$150 million a year in dividends. And TI is even buying back its own shares—\$300 million worth in the past six months alone—to cover exercises of employee stock options. Says Chief Financial Officer William A. Aylesworth: "We believe we have a strong balance sheet, especially in view of the severe market downturn."

TI is not alone. As always in an economic slump, cash is once again king, and companies are going all out to make sure they have enough of it.

BusinessWeek's flash profits survey found that net earnings fell 54% at 124 bellwether companies in the third quarter. But early indications suggest that cash positions haven't deteriorated nearly as badly as that. At many large companies, they are even improving. Businesses are taking steps to keep cash from going out the door, and they are bringing in fresh money by borrowing to create a cushion to carry them through hard times.

BILLIONS ADDED. Take, for example, the companies in the Standard & Poor's 100. Of those, 22 reported changes in cash flows in their press releases for the latest fiscal quarter. *BusinessWeek* toted up the changes in cash for the 22 companies and found that they had added \$13 billion in cash in the latest quarter, vs. shedding \$7 billion in cash a year earlier. General Motors Corp. and Ford Motor Co., which raised cash through debt offerings and securities sales, account for most of the jump, but the others increased their stockpiles,

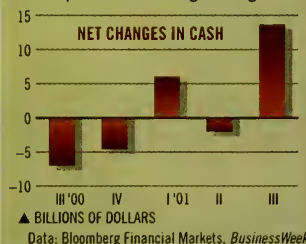
too. Of course, companies that chose not to mention cash in their press releases may not have done as well as the 22 that did report.

Accounting rules go a long way toward explaining why corporate cash positions can improve when profits fall. For one thing, companies have massively overinvested in capital equipment. Now they're writing off unneeded gear and de-

preciating what's left as it becomes worn out and obsolete. It's appropriate that depreciation and writedowns are squelching profits, because those assets—and therefore the companies—truly aren't as valuable as they were thought to be. But the enormous accounting adjustments don't drain cash, which is what counts for paying the bills. "The drop in profits will be greater than in any post-World War II recession—even though

SQUIRRELING IT AWAY?

Of the S&P 100 companies, 22 have reported cash flow data through the most recent quarter. As a group, their cash position is strengthening.



the decline in GDP is relatively modest," says Michael K. Evans, chief economist of American Economics Group Inc. in Washington, D.C.

Companies are also building cash in ways that don't show up in profits, including such maneuvers as cutting inventories, demanding quicker payment from customers, and slowing down payments to suppliers. For instance, using up old parts from inventory saves cash but doesn't boost net income, because accountants deduct parts costs from revenue at the time a sale is booked. Circuit City Stores Inc. of Richmond, Va., for example, has cut inventories by getting suppliers to deliver more often in smaller lots. And it's slowing payments—forking over the



to increase liquidity, corporations are issuing lots of debt: They sold a record \$29.7 billion in bonds in the week ended Oct. 26, according to Dealogic CommScan LLC.

The companies in the best shape, though, are those that can generate plenty of cash through operations. United Technologies Corp. CEO George David says that the company's strong credit rating allows it to sell more jet engines because it can extend credit to hard-pressed airlines. Of course, that places an extra burden on the company's finances. To make up for the hit from its concessions to the airlines, David says, United Technologies is cutting capital spending and may postpone some acquisitions. It added \$408 million in cash in the third quarter.

While some companies, notably in the telecom industry, built up enormous amounts of debt in the fat years of the late 1990s, others used the good times to clean up their balance sheets. For instance, Gary M. Pfeiffer, chief financial officer of DuPont Co., says the company has been able to reduce capital spending by getting better use out of the equipment it already owns. Partly as a result, Pfeiffer says, DuPont has its strongest balance sheet in 25 years despite the worst market in 25 years.

But for young tech companies experiencing their first slump, paying attention to

shrinking rapidly. That helps cash flow because it's earning revenue without having to buy parts. Palm Inc. executives are so focused on cash that they get daily updates on it from their wireless Palm VIIx handhelds.

Cutting back on share repurchases is one of the simplest ways to improve cash flow. But companies usually do it with a wince—after all, a year or so ago, they were buying shares by the truckload when they were far more expensive. Boeing Co. suspended its repurchases after September 11 as part of a cost-savings program that included laying off 20,000 to 30,000 workers. R.R. Donnelly & Sons Co., the world's largest commercial printer, has completed only little more than half of a planned \$300 million repurchase program for the year 2001. Its magazine-, catalog-, and prospectus-printing work has slumped. Says CEO William L. Davis: "With a lot of economic uncertainty, we must work hard to protect and preserve cash flow."

REVERSE EFFECT. To be sure, some things companies do to conserve cash in the medium term can actually force bigger outlays in the current quarter. Layoffs, for example, sometimes require big severance payments. For many small companies, moreover, the options for protecting cash are limited. They often can't borrow or sell stock in a downturn. They're also the most likely victims when the big guys squeeze suppliers, notes Aswath Damodaran, a finance professor at New York University's Stern School of Business. "It's the bottom 10% or 20% of companies that are most at risk," he says.

Not to mention another problem: Corporate efforts to save cash aren't an unalloyed benefit for the economy. For every company that cuts capital spending or stretches out its payments, there's another that's not making a sale or not getting its money quickly. Indeed, vigorous efforts to preserve cash are exacerbating the downturn, says Edward E. Yardeni, chief investment strategist at Deutsche Banc Alex. Brown Inc. "It's the law of unintended consequences.

What makes sense for any individual company makes a mess for all of them collectively," Yardeni says.

Still, when times get tough, hard-pressed companies don't stop to worry about the collective good. That's why so many of them are zeroing in on cash—and producing gains that don't always show up on the P&I statement.

*By Peter Coy in New York,
with Michael Arndt in Chicago
and bureau reports*

Businesses are writing off huge sums in capital equipment. But those accounting adjustments don't drain cash

ney when it's owed, but no earlier. Such squeeze tactics are not the only source of cash for companies. Yet another is slashing capital spending: Orders for new capital equipment fell more than 11% in September. Companies are cutting dividends, slowing or ceasing stock buybacks, and forgoing acquisitions by cash. All of those measures protect cash flows, but they don't do as much for net income. As another tactic

mundane items such as working capital and cash flow is a whole new experience. In early 2000, Palm Inc. of Santa Clara, Calif., was getting beaten up for not meeting demand for its handheld computers, which was growing 100% a year. Now its shares are off 96% from their peak and it's losing money. So Palm has gotten tough with itself. It cut production even more than final sales dropped, so inventories have been



COMMENTARY

By Howard Gleckman

A STIMULUS DEAL IS CLOSER THAN IT SEEMS

To listen to the overheated rhetoric in Washington, it sounds as if the economic stimulus plan could founder on the rocks of old-fashioned partisanship. Democrats are loudly demanding big new spending programs, while Republicans are playing to their loyalists by insisting on huge tax cuts. The GOP rammed its version through the House on Oct. 24 on a nearly party-line vote. In the Senate, competing plans appear daily. And on Oct. 31, a frustrated President Bush called on Congress to pass a stimulus by the end of November: "Get to work and get something done," he said.

Yet in reality, the parties are much closer to a consensus than their speeches suggest. Says Iowa's Charles E. Grassley, senior Republican on the Senate Finance Committee: "I don't think we are any farther apart than we were last spring"—when Congress easily passed President Bush's tax cut. Adds Senator John B. Breaux (D-La.): "The differences are not insurmountable."

Lawmakers have coalesced around the basic elements of a \$75 billion-to-\$100 billion plan. Its key pieces: temporary tax cuts for new business investment, including faster first-year write-offs for new equipment; tax cuts for low-income workers who didn't get rebates earlier this year; and extra benefits for workers who have lost their jobs recently. Economists say these elements would have a small but positive impact on consumption and capital spending.

STICKING POINTS. Still, the political slow-dancing over key details may continue for weeks. There are three big sticking points. The first: how much to spend on public works. Democrats favor \$20 billion for roads, bridges, and transit, while Bush opposes any new funding. The Hill GOP publicly backs Bush, but privately many lawmakers also want to fund local projects. The likely compromise:



"GET TO WORK": Bush wants Congress to move faster

at least \$10 billion in added spending. It won't help today's economy much, though, because actual digging wouldn't begin for at least a year.

Lawmakers will also have to find a middle ground on a GOP plan to accelerate the individual rate reductions that were enacted last spring, but are not scheduled to kick in until 2004 or 2006. Republicans want them now. "It's the Holy Grail for the R's, and it's a nonstarter for us," says a Senate Democratic aide. The deal?

WHAT DEMOCRATS AND REPUBLICANS AGREE ON...

- A temporary tax cut for new business investment that provides faster first-year write-offs for new equipment
- A tax rebate for low-income workers
- Extra benefits for workers who have lost their jobs in recent months

...AND WHAT THEY DON'T

- What health benefits to provide the newly unemployed
- How much Congress should spend on big new public-works projects

An immediate cut in only the 27% tax bracket that would give middle-income workers a few extra dollars.

The third battle will be over how to help laid-off workers who have lost health insurance. Today, businesses must offer coverage to ex-employees for 18 months, though workers must pay up to 103% of their premiums. Since that's prohibitive for many, Democrats and some moderate Republicans want Washington to temporarily defray 50% to 75% of the cost.

Bush and most Hill Republicans oppose a subsidy but would give states money to help the unemployed obtain insurance. This issue has stalled congressional negotiations for weeks and no deal is on the horizon.

It seems clear, though, that many of the controversial provisions in the House bill will be jettisoned. For instance, while Congress is likely to give companies some relief from the alternative minimum tax, it won't give them a \$25 billion rebate for the AMT taxes they've paid over the past 15 years, as the House did.

FRUSTRATION. On other issues, lawmakers are likely to split the differences. For instance, the House would let businesses enjoy new investment incentives for three years. Senate Finance Committee Chairman Max S. Baucus (D-Mont.) prefers one year. The easy compromise: 18 months. When it comes to the big issues, says Clint Stretch, a Washington partner at accountants Deloitte & Touche, "they are all singing from the same song sheet."

Perhaps, but the last act of this drama is taking longer than frustrated Administration officials would like. To close the deal, the President will have to do some compromising. And he'll have to lean harder on lawmakers to stop their demagoguery and start putting economic recovery ahead of politics.

With Rich Miller in Washington

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COMMENTARY

By Michael Arndt

UNITED HAS CUT
ALMOST A THIRD
OF ITS FLIGHTS

A TO-DO LIST FOR UNITED'S MR. FIX-IT

Ten years ago, John W. Creighton Jr. saved Weyerhaeuser Co., the timber and paper-products giant, that then lagged rivals in profitability and share price appreciation. Creighton—who became CEO of Weyerhaeuser in 1991—sold off anything peripheral or rutted in a low-margin market. It took four years, but he turned the company into a leader again.

Now Creighton, a director who was named chairman and chief executive on Oct. 28 of UAL Corp., the corporate parent of United Airlines Inc., has another troubled giant to rescue. But this time around, he has no time to lose. Since the September 11 terrorist attacks, United has grounded 31% of its flights and furloughed 20,000 employees. Yet it is still burning \$20 million in cash a day and is expected to lose \$1.8 billion this year. The situation is so dire that Creighton's predecessor, James E. Goodwin, warned in a mid-October letter to employees that "United will perish sometime next year" unless the hemorrhaging ends. Goodwin's unusual candor cost him his job, but he may well be right. "Could the company file for bankruptcy? Yes, it could," says Brian Campbell, president at consultancy Campbell-Hill Aviation Group. "[UAL] got hit like a ton of bricks."

So does Creighton, 69, have a shot at keeping United aloft? Its problems are deep-rooted—not least because of its extremely potent labor force. Unions own 55% of UAL's stock and hold 2 of 11 seats on the board—one reason the carrier has labor costs among the highest in the industry. The result: a frequently intransigent culture that has defeated the

reforms of half-a-dozen CEOs. And Creighton can do little to alter United's treacherous environment. Only a rebounding economy and an end to terrorism will fill planes again.

But unlike the aloof Goodwin, Creighton has the confidence of United's unions. A lawyer and accountant who oversaw a heavily unionized workforce at Weyerhaeuser, Creighton was recommended for the job by R. Thomas Buffen-



CREIGHTON

**For starters,
United's new
CEO has to
coax unions to take a
pay cut—while
simultaneously
raising morale and
improving service**

barger, who heads the International Association of Machinists. "The key is the unions," says ABN Amro Inc. analyst Raymond F. Neidl. "They have been obstinate." To change that dynamic, here is where Creighton must start:

■ **Pare Labor Costs.** Creighton must persuade the airline's richly paid workers to take pay cuts that mirror its newly diminished revenues. Goodwin sanctioned record pay hikes; now, Creighton should open up the books to union reps and more clearly

explain—with the help of neutral outside accountants chosen by both sides, if needed—what will happen if labor rates do not fall.

■ **Restore Morale.** If rank-and-file workers balk, Creighton could help sell the belt-tightening by unilaterally reducing management salaries. He might even set an example himself by forgoing a salary until UAL is profitable again. He should also clean house. United's management ranks are exceptionally thin, and its top execs have lost the trust of employees and investors. Creighton should quickly bring in a half-dozen new leaders from outside the industry and groom a successor.

■ **Boost Service.** Improved morale will help, but to gain a bigger share of passengers still flying, Creighton should borrow a move from Continental Airlines Inc. In the mid-1990s, managers there began awarding bonuses based on on-time performance and baggage handling goals. The resulting improvements in service reduced costs, won back customers—and made workers happier. And there's no reason United—like rival Northwest Airlines Corp.—can't boost X-ray screening or other safety measures on its own. Increasing passenger confidence may be the most effective airline marketing nowadays.

And should reason fail? If UAL continues to bleed red ink, some analysts say bankruptcy—which would allow it to abrogate its union contracts—may be its only hope. Given the risks, such a move would clearly be a last resort. But Creighton should not forget that it remains in the tool kit.

Correspondent Arndt covers airlines from Chicago.

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COKE TRIES JUICING THE BOTTOM LINE

WITH ITS SODA BUSINESS FLAT, Coca-Cola is counting on juice and other healthy drinks to put the fizz back in its bottom line. Its latest move: On Oct. 30, the Atlanta soda giant agreed to pay \$181 million for Odwalla, a California-based maker of juices, smoothies, shakes, and soy beverages. Coke hopes to use its ubiquitous distribution to expand Odwalla's reach, which now extends to only 1,000 U.S. retail outlets. The deal is the latest in a string of noncarbonated acquisitions for Coke, which earlier this year acquired the PlanetJava coffee brand and the Mad River Traders line of teas and juices. Still, analysts say Coke needs to do more in the fast-growing health and wellness category to rival PepsiCo, which not only acquired the trendy SoBe brand last year but also snatched the flavored line from Coke af-

ter its board vetoed the deal at the last minute.

THE 30-YEAR T-BOND: SAY BYE-BYE

ON OCT. 31, TREASURY BONDS posted their biggest daily gain since the October, 1987, stock-market crash after the Treasury Dept. said that it will stop issuing the 30-year bond. The move will minimize the government's borrowing costs and help bring long-term interest rates down. The role of the 30-year security as a benchmark has diminished since the agency began paring back its issuance in the 1990s. "The 30-year bond was becoming a costly orphan," explains James Glassman, senior economist at J.P. Morgan Chase. The government began selling 30-year bonds in 1977 and has issued more than \$600 billion.

THE SWANKIEST WHISKER-WHACKER?

IS THERE ANY LIMIT TO WHAT men will pay for a shave? On Oct. 30, Gillette unveiled an improved version of its wildly successful Mach3 razor. The Mach3Turbo is expected to sell for \$9 for a razor and two cartridges when it is launched next April. That would easily make it the world's most expensive mass-market razor. A steep price, but history suggests millions of men will pay the 15% premium over Mach3 for the Turbo's improvements. Gillette initially charged a much steeper 35% premium for Mach3 when it was introduced in 1998. But Mach3 still became the world's No. 1 blade.

A SPORE SABOTEUR GETS THE NOD

WHEN ANTHRAX SPORES started showing up in the

HEADLINER: GARY WENDT

HE CAME, HE SAW, HE DIDN'T CONQUER

CONSECO CEO GARY WENDT hasn't lived up to the fanfare that greeted him last year when he arrived after an illustrious career as CEO of GE Capital. On Oct. 30, Consec posted a \$411 million third-quarter loss and took a \$471 million charge, writing down the value of much of its assets. The Carmel (Ind.) finance and insurance firm also cut its fourth-quarter estimates to 17¢ a share, down from 33¢. That sent the stock plummeting 27% in the next two days to \$2.95, an 85% drop from its \$20.24 high in May.

Salomon Smith Barney

analyst Colin Devine worries that Consec won't have enough earnings from operations to meet the \$1.4 billion in interest and principal payments due in 2002 on its 6 billion in debt. Wendt disagrees. "We have excellent and predictable cash flow from

operations, and we have multiple options to generate additional cash," he says. Still, the economic downturn is likely to further squeeze Consec's mid- to lower-income customers. Nobody said it would be easy for Wendt.

Pallavi Gogoi



CLOSING BELL

SLIPPED MICKEY

McDonald's shares wilted after the fast-food giant warned on Oct. 29 that the widening global economic slowdown will cause 2002 earnings to fall well below forecasts. Big Mac also disclosed it will take a \$175 million charge in this quarter for layoffs. McDonald's closed Oct. 31 at \$26.07, down 10% in three days.



mail, Titan saw an opportunity and seized it. On Oct. 26, the San Diego-based company won a \$40 million contract to supply mail-sanitation systems to the U.S. Postal Service through its subsidiary SureBeam. Unlike competing radiation-based systems, Titan's technology uses electron beams to kill bacteria. Until now, it has primarily been marketed for sterilizing food and medical devices. "We went to the postal service and said we could adapt our technology to help deal with this threat," says Chairman Gene Ray, who adds that Titan has been using the SureBeam system to sterilize its own mail.

FIDELITY LAYS OFF SOME FAITHFUL

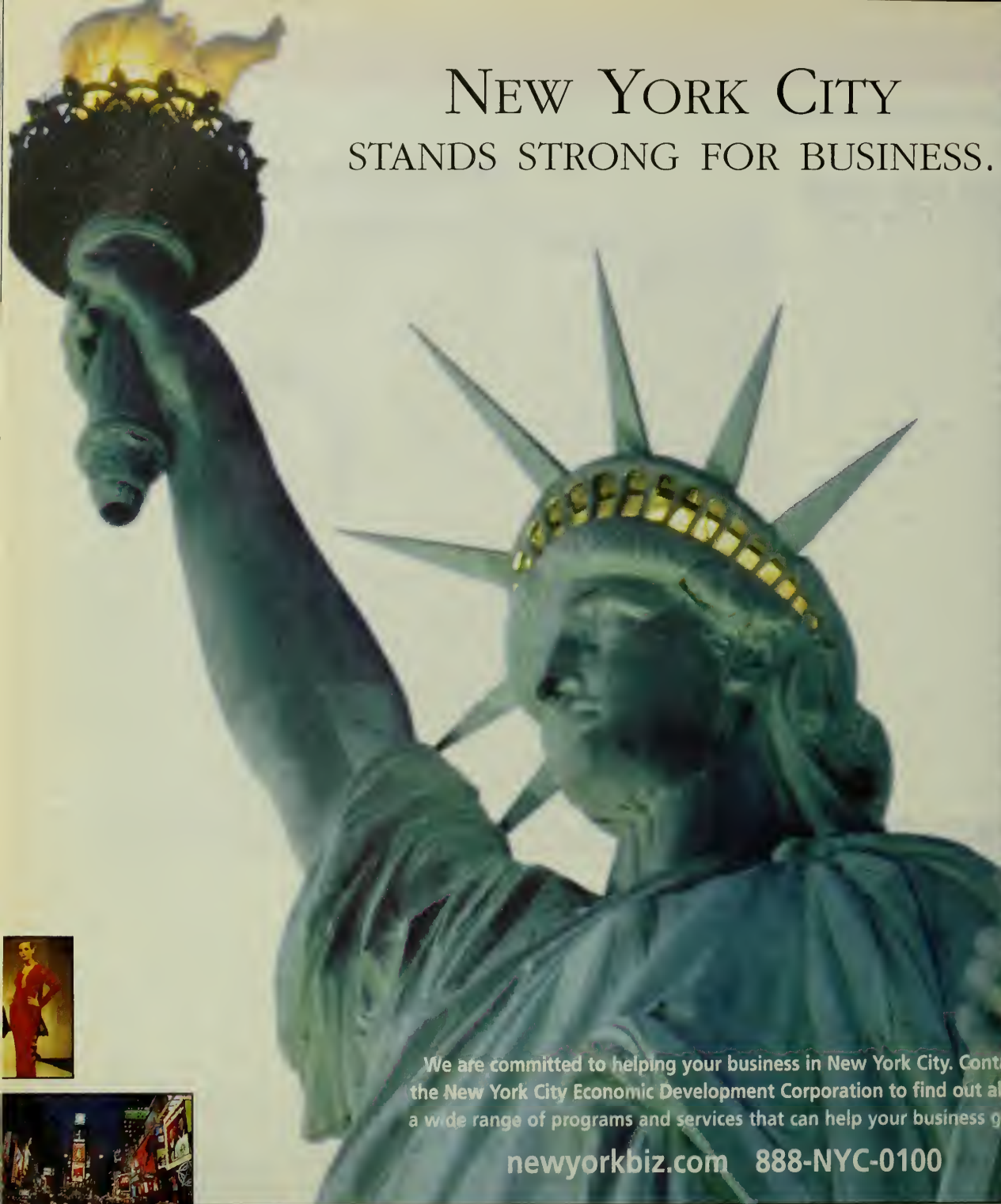
FIDELITY INVESTMENTS announced that it was cutting 760 jobs on Oct. 30, joining a long list of financial-services

firms laying off employees. Along with 354 positions pared this summer, Fidelity's dismissals amount to 3.4% of its 32,847 employees prior to the reductions. Privately held Fidelity has resisted putting people out of work, partly in an effort to prove its financial might in comparison with its competitors. Still, the shallow cuts are a sign Fidelity is optimistic. Its core mutual-fund business had net sales of \$15.3 billion through September, more than double last year's sales. Fidelity says it expects no more layoffs this year.

ET CETERA...

- Alltel is buying 600,000 telephone lines from Verizon in Kentucky for \$1.9 billion.
- Qwest Communications reported an unexpected loss for the third quarter.
- Allied Waste Industries COO and president Larry Henk resigned Oct. 30.

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EDITED BY RICHARD S. DUNHAM

THE NEW ODD COUPLE IN TOWN: GEORGE AND TEDDY

At an Oct. 24 White House briefing on bioterrorism, Senator Edward M. Kennedy (D-Mass.) held the seat of honor at President Bush's right hand. As the meeting began, a smiling Bush turned to grab Kennedy's arm: "I hear we're making great progress on the education bill," he said. "It's all due to you, Senator Kennedy."

The chumminess was enough to make party hard-liners gag. But the kinship between these two pedigreed sons of American political dynasties is sincere. Despite their substantial policy disagreements, the neophyte President and veteran senator have developed an easy rapport that has furthered each man's agenda.

"COMMON GROUND." And that has made Kennedy—who seemed politically isolated after the GOP took the White House and Congress last November—more influential than he has been in decades. When he cut a bipartisan deal on education reform, Bush's top domestic priority, angry Democrats said he had given up too much in return for establishing his bona fides with the President. Says a top Democratic aide: "We paid a price." But Kennedy apparently didn't. Now, as the war on terrorism pushes domestic issues to the back burner, the Bush-Kennedy team is still going strong, turning its attention to bioterrorism, immigration, and the economy. "Working with Bush isn't sacrificing principle, it's trying to find common ground," Kennedy says.

Even though strange bedfellows are nothing new to Washington, this pair was something of a shock to the system. After the 2000 election left the Senate almost evenly divided, conventional wisdom had Bush reaching out to moderates such as John B. Breaux (D-La.) and Joseph I. Lieberman (D-Conn.), who are ideologically more in sync with the Prez. But Bush found himself increasingly comfortable around the plain-

spoken Massachusetts liberal. Indeed, the Kennedy-Bush relationship dates to 1959, when Kennedy, chair of the student law center at the University of Virginia, invited the President's grandfather, Senator Prescott Bush, to speak.

Now, with Dems in control of the Senate and Kennedy at the helm of the Health, Education, Labor & Pensions Committee, he is even more important to Bush. For Kennedy, across-the-aisle alliances aren't new. Despite his staunch liberalism, he is a pragmatist willing to sacrifice ideological purity for policy gains. In the late 1990s, he teamed up with conservative Senator Orrin G. Hatch (R-Utah) on a series of bills that expanded spending on children's health care and aided everyone from immigrants to radiation victims. "I literally came here to fight Kennedy, [who was] wrecking the country," Hatch says. These days, he calls Kennedy "patriotic" and "decent." Adds Hatch: "In almost every case, he's come to the center, and I've had to move to the center, too." When Bush won the White House, Hatch suggested that he reach out to Kennedy for help with his agenda.

In coming weeks, Kennedy will partner with Bush ally Senator Bill Frist (R-Tenn.) on a bioterrorism bill that will pay for vaccine stockpiles. With conservative Senator Sam Brownback (R-Kan.), Kennedy is crafting an immigration bill that will include Bush initiatives to improve oversight and tighten student-visa laws.

Kennedy's dance with Bush didn't stop him from heading the opposition to Linda Chavez as Labor Secretary. But when the two disagree, the attacks never get personal. "We're working in good faith," Kennedy explains. That could be a formula for further success—for both the liberal senator and the conservative President.

By Lorraine Woellert



PRAGMATISTS and pals

CAPITAL WRAPUP

NO MAIL? NO PROBLEM

► Given the concerns about the security of the U.S. Postal Service, lobbyists are being forced to get creative to put their message across. Take the National Association of Realtors. After compiling 35,000 letters of support for the NAR's push to derail a regulation that would enable big banks to enter real estate brokerage and property management, the NAR didn't drop the letters in the mail. Instead, NAR officials walked the letters over to 1600 Pennsylvania Ave.

LOW-TECH LOBBYING

► On Capitol Hill, with offices shuttered by the anthrax scare, lobbyists are struggling to twist the arms of lawmakers who have had limited access to computers, phones, and faxes. Several groups, including the U.S. Chamber of Commerce, tried sending mass e-mails to members' BlackBerries. But they found that lawmakers aren't using the gadgets. "You can't phone 'em, you can't mail 'em, you can't fax 'em," gripes Chamber lobbyist R. Bruce Josten. "It's a bitch." The solution: old-fashioned button-holing.

AGRO-TERRORISM?

► Beware lawmakers who add the word "terror" to any funding request. One costly example: Senator Pat Roberts (R-Kan.) wants to amend the farm bill with an "agro-terrorism" measure. It would mandate spending \$4 billion to increase security at Agriculture Dept. laboratories. But Senate Budget Committee Chairman Kent Conrad (D-N.D.) warns that if the farm bill isn't passed this year, the worsening budget outlook could reduce the \$167 billion in aid farmers are expecting.

PUTIN'S R



For two weeks after the September 11 attacks on the World Trade Center and the Pentagon, Russian President Vladimir V. Putin seemed to go into a deep sleep. True, he was the first world leader to call President George W. Bush to express his condolences. Afterward, though, Putin retreated to a luxurious *dacha* in the Black Sea resort of Sochi, frequented by Kremlin leaders since the days of Nikita Khrushchev. Leaving the day-to-day running of the government to Prime Minister

Mikhail Kasyanov, Putin spent hours on the phone with global and regional leaders. Yet he kept silent as hard-line aides publicly set sharp limits on Russia's participation in the U.S.-led anti-terrorism campaign.

But as it later became clear, Putin was not hibernating. He was hatching a plan to back America. Some members of his own team, including those in the military, were left out of the loop—though U.S. diplomats at the American Embassy in Moscow, clued to continuing telephone conversations between Putin and Bush

RUSSIA



At an historic moment, it's emerging as a key U.S. ally

SPECIAL REPORT

A CHANGING RUSSIA 66

BOEING'S GAMBLE 71

BUSH AND PUTIN 74

BusinessWeek | online

For stories on Russia's capitalists, the Chinese in Russia, and school reform, go to the Nov. 12 issue online at www.businessweek.com.

knew where the Russian President was headed. "He's with us," a senior embassy official said on Sept. 24. "And he is all by himself." In a television address that evening, Putin jolted hard-liners by backing the basing of U.S. forces in former Soviet republics in Central Asia.

TURNING POINT. That was just the start of the surprises. At an Oct. 3 meeting at NATO headquarters in Brussels, Putin softened his own opposition to NATO expansion to the Baltic

LOOKING WEST

With closer ties to the U.S. Putin could save billions

states, on Russia's border, and even expressed interest in Russia joining the organization created in 1949 to check Soviet expansionism. Then came his announcement that Russia would pull out of its cold-war era bases in Cuba and Vietnam.

Now Putin is headed for a summit with Bush in the U.S. on Nov. 12-14. The meeting, held while the rubble still smokes at the World Trade Center, could prove an historic turning point in Russian-U.S. relations. Missile defense, arms treaties, cooperation on fighting terrorism, business deals—it's all on the table. And Putin is determined to make things happen. After months of warning the Bush Administration against abandoning the 1972 Anti-Ballistic Missile Treaty, he now appears willing to scale back the accord. Such a step, controversial at home, would give the green light to the Bush team's key foreign policy aim—to develop a missile defense system. Bush and Putin would also dramatically curtail the numbers of warheads maintained by America and Russia. The cutbacks—to as low as 1,500 on both sides—could save billions for Russia, which over the next quarter-century may need up to \$2.5 trillion to replace outworn Soviet-era infrastructure.

Putin's push for closer security ties to the U.S. is part of a wider gambit. He wants to lead Russia closer to the West in a broad and urgently needed modernization—not just of its battered army but also of its economy, schools, and legal institutions. The goal is to create for post-Soviet Russia a lasting place in the family of nations to which Putin feels his country rightly belongs—even though it now lags behind by just about every conceivable measure.

It's hard to believe these bold gestures are coming from a man few in the West even knew just two years ago, when

SPECIAL REPORT



Putin emerged from the tumult of Russian politics as Boris N. Yeltsin's designated successor. And when his past became known, American policymakers immediately wondered if the steely-eyed, impassive Putin would engineer the return of the Soviet security state and deal Russian democracy a death blow. Here, after all, was a lawyer who had spent his career in the KGB, the intelligence agency that had waged cold war abroad and at home. Few in the West thought they could deal with this ex-spy-master.

QUIET EDUCATION. Yet for those who looked, the signs were already there that Putin was not a rigid ideologue. A posting in East Germany in the 1980s gave him the chance to learn the differences between the Eastern and Western German economies and societies firsthand. Those lessons stuck: Putin was gradually won over to the side of capitalism. After the Soviet Union collapsed, he helped attract Western investment to St. Petersburg as a deputy in the mayor's office.

The upcoming meeting with Bush is a culmination of those formative years. But even now, it's hard to know how he will play his cards. Unlike the gregarious and impulsive Yeltsin, Putin tends to seek counsel only from trusted aides like Chief of Staff Alexander S. Voloshin, whom Kremlin insiders say encouraged the tilt to the U.S. after the September 11 attacks.

It may be through his martial-arts training that Putin acquired his trademark negotiating style—his ability to turn the strength of his sparring partner to his own advantage. "Judo is not just a sport," Putin said in *First Person*, a collection of interviews published last year. "It's a philosophy."

A philosophy that pairs nicely with his own *realpolitik*. Putin's calculation is that the best hope for a prosperous Russia

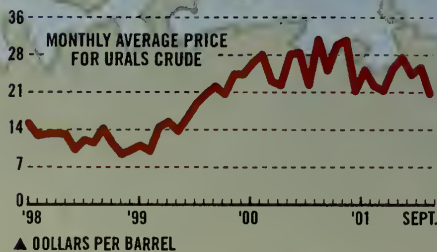
PORTRAIT OF A CHANGING RUSSIA

Russia is second only to Saudi Arabia in oil production

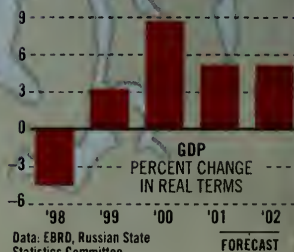


The Economy

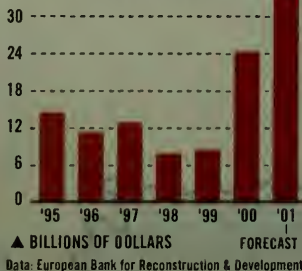
AS PRICES FOR RUSSIAN OIL INCREASED...



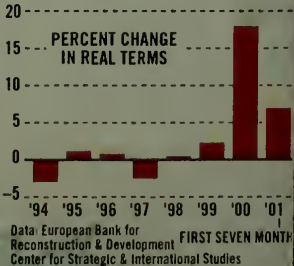
...ECONOMIC GROWTH PICKED UP...



...IMPROVING FOREIGN RESERVES...



...AND STRENGTHENING CORPORATE INVESTMENT



es in its integration into Western-led institutions, including the World Trade Organization. By cooperating with the U.S., Russia wins the West's respect—an intangible advantage but a real one. For as relations grow warmer, Putin hopes to convince investors that Russia is no longer the sinkhole it once was. And as investment accelerates, Putin can argue to Russians that the way to keep money flowing is to continue advances in corporate governance and transparency. As Putin declared on Oct. 21 at a news conference with Bush in Shanghai, "our priority is partnership, a partnership based on the common values of one civilization."

STRONGER ECONOMY. Yet if America is vital to Putin, Russia is important to Washington in a way that hasn't been true since the war on Nazism. Not only does Bush want a strategic tie-up that will allow the U.S. to move ahead with missile defense, he wants a U.S.-Russian alliance in the campaign against terrorism, which could last years. In a trip to Moscow slated for Nov. 3, U.S. Secretary of Defense Donald H. Rumsfeld is expected to work out with the Kremlin plans for using Russian military bases and troops in search-and-rescue missions in the war in Afghanistan. Russia's territory is vital. It stretches from the Sea of Japan to the Gulf of Oman. Iran is just across the Caspian Sea. The KGB and its successor agencies have monitored the activities of Islamic groups on Russia's borders for years. The Bush team also sees Russia as a source for crude oil should U.S. relations

with Saudi Arabia deteriorate. Pumping seven million barrels a day, Russia is second only to the Saudis in oil production.

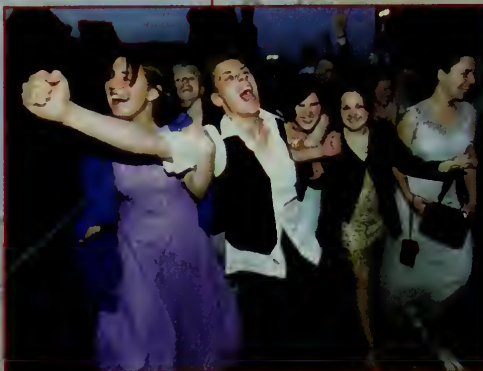
One factor that could strengthen this new alliance is that Putin, unlike Yeltsin, is not coming to Washington with his begging bowl out. Flush with export revenues from oil, gas, and other commodities, Russia in October prepaid a \$350 million installment on a loan from the International Monetary Fund due in 2003.

Instead, Putin is seeking to expand relationships with sophisticated players such as ExxonMobil Corp. and United Technologies Corp. And he's working to persuade them they can make money in Russia, whose economy has grown strongly in the last two years after a decade-long depression. Elements of the post-Soviet kleptocracy have started to fade. Though the mob still exists, gangland killings—a fairly common occurrence in the early 1990s—seldom take place these days.

True, plenty of corporate chieftains still seek to win favors for their businesses through bribery and other means. But a growing number of companies are succeeding through savvy management and high-quality products. Moscow-based juicemaker Wimm-Bill-Dann, which got marketing advice from U.S. agribusiness giant Cargill in the early 1990s, now exports beverages to the U.S., Europe, and the Middle East. Attentive investors like Boeing Co., aware of the improvements, are planning fresh commitments (box, page 71).

You can sense the change in the streets. Take a stroll along central Moscow's Tverskaya Street, where the commercial landscape is unrecognizable from a decade ago. Restaurants serve the latest in fusion cuisine. Boutiques display leather pants for the fast set. Neon billboards line the thoroughfare. Here, shoppers increasingly are buying improved domestically made

Moscow party: The best and the brightest want to stay in Russia



Public Opinion

HOW RUSSIANS VIEW AMERICA

The people are still ambivalent, even after recent events

Is America friendly or unfriendly to Russia?

	BEFORE SEPT. 11, 2001*	AFTER THE TERROR ATTACKS**
FRIENDLY.....	32%	38%
UNFRIENDLY.....	52%	46%
HARD TO SAY.....	16%	16%

Does America play a positive or negative role in the world?

	BEFORE SEPT. 11, 2001*	AFTER THE TERROR ATTACKS**
RATHER POSITIVE.....	20%	26%
RATHER NEGATIVE.....	58%	48%
HARD TO SAY.....	22%	26%

How did America become the richest country in the world?

EXPLOITATION.....	52%
OWN EFFORTS.....	33%
HARD TO SAY.....	15%

Sept. 17-18, 2001

**Sept. 29-30, 2001

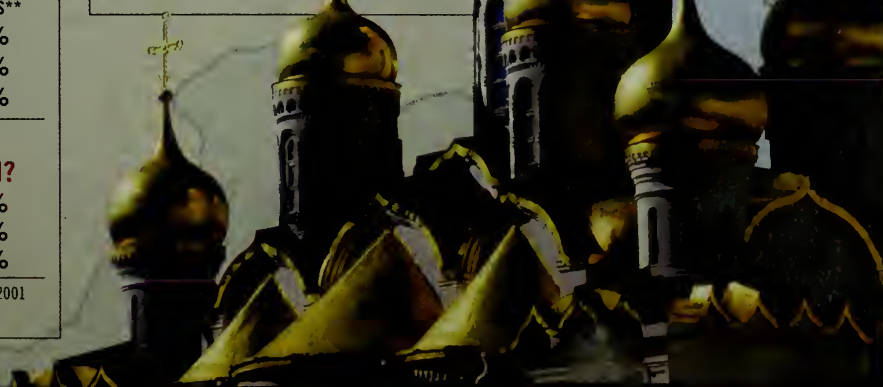
Data: All Russia Public Opinion Foundation

Living Standards

	1991	2001*
GDP PER CAPITA (\$)	\$92	2095
INFLATION (%)	93	19
PRIVATE SECTOR SHARE OF GDP (%)	5	70
PRIVATE CAR OWNERSHIP**	79	224
LIFE EXPECTANCY***	69	67

*Forecast **Per 1000 ***Average men and women
Data: European Bank for Reconstruction & Development, Russian State Statistics Committee, World Bank Development Indicators 2001, William Davidson Institute, United Financial Group, Center for Strategic & International Studies

Cathedral of the Annunciation in Moscow



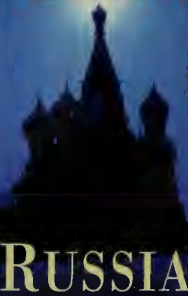
goods from manufacturers like television-set maker Rubin and refrigerator maker Stinol.

Of course, Bush and other Western leaders remain concerned about the nasty edges of Putin's Russia. They are well aware of Putin's disturbing efforts to chill criticism of such policies as his brutal military campaign against Chechen rebels. But Western leaders, too, are practicing *realpolitik*. "It is clear that President Putin understands that Russia's future lies primarily in the West," Secretary of State Colin L. Powell told the Senate Foreign Relations Committee on Oct. 25. "That's the source of inspiration, that's the source of technology, it's the source of capital, it's the source of security."

So Washington is rolling out the welcome mat. As a gesture to Putin before his departure for America, Rumsfeld on Oct. 25 announced a postponement of planned missile tests the Administration said might have violated the ABM treaty. Resistance may be softening to Putin's long-term demand for a treaty to codify any new security arrangement. "That would be a huge victory for Putin," says U.S.-Russia analyst Michael McFaul at Stanford University (page 74).

The big question is whether Putin's ever-balky country is ready to follow his lead. From Peter the Great at the outset of

SPECIAL REPORT



Russia's prominent business leaders. After a decade of robber baron capitalism that burned Western investors, these bosses now say that kleptocratic practices proved a dead end for a country with an annual gross domestic product of \$300 billion, on a par with the Netherlands. "Russia tried to live by its own rules," says metal baron Vladimir O. Potanin, president of Moscow-based Interros. He's backing Putin's effort to accelerate Russia's entry into the WTO, which imposes rules for competition on members.

BACK ON TRACK. Putin can also count on youthful idealists who thirst for national renewal. Students are seeking a sense of "national dignity" for a country humiliated by the Soviet Union's collapse, says Andrei Isserov, a 21-year-old graduate student at Moscow State University whose focus is American history. Fluent in English and a devoted reader of the Western press, Isserov is not looking for Russia to become a copycat of the U.S. "But we would like to feel ourselves European," he adds. Convinced Russia is getting back on track, Isserov and his friends plan to make their careers in their homeland. That's heartening for a nation that has seen many of its brightest minds depart for Israel, the U.S., and Europe.

Though Putin can rely on the urban elites, the rest of Mother Russia has yet to embrace the West. The Communist Party remains the biggest grassroots political machine and a font of anti-American rhetoric. Communist leader Gennady Zyuganov calls Bush's demand that nations stand with or against America on terrorism "blackmail."

One source of such hostility is the failure of U.S.-backed market reforms in the early 1990s. "It may not be beneficial for big American financial powers to see Russia strong and prosperous," says Alexander Sukharev, 33, an engineer who gets by with a job at a German tourist agency in Moscow. Such sentiments are unsurprising in a country where the average monthly wage is \$11 and 35% of all people live below the poverty line. On military issues, cold-war attitudes are still widespread. "NATO is our enemy," says a 19-year-old Russian soldier stationed at Russia's border with Estonia.

Putin's domestic challenge is immense, even if he does enjoy 75% approval ratings. That's why it's essential that Putin's pro-West policy has a quick economic payoff. The recovery has been a principal contributor to his popularity. Boosted by high oil prices, GDP last year grew by 8.4%. This year, even with softening oil prices, Russia

is still one of the world's fastest growing economies, with GDP expanding at a 5.5% clip.

FLAT-TAX POLICY. Of course, the economy, as well as government tax revenues, remains dangerously dependent on one industry. Energy sales directly account for 16% of GDP, and a third of federal budget revenues, sustaining equipment suppliers and providing income for the nation's banks, law and advertising firms, and retail outlets. Every \$5 drop in the price of crude costs Russia about 1% of GDP. A sustained decline in oil prices would be "very dangerous for the economy" and would threaten Putin's political standing, says Oleg V. Vysotskiy, chief economist at Moscow brokerage Troika Dialog and former deputy finance minister for Yeltsin.

No wonder Putin has tried hard to keep the momentum going. In a supply-side plan more radical than anything under-



the 18th century to Boris Yeltsin in the last decade, Westernizing Russian leaders have stirred backlashes that have jeopardized their programs and sometimes their lives. Few in government dare criticize Putin openly. Yet a push is on within the military and security services to make Defense Minister Sergei Ivanov into a conservative counterweight to the President. Putin embarrassed Ivanov, a close associate, by overruling him on the decision to permit U.S. bases in Central Asia. "Opposition to his policy of bringing Russia to the West is growing," says Moscow political analyst Andrei A. Piontkovsky.

So the U.S. had better come up with enough concessions on security issues such as the ABM treaty, suggests a Kremlin aide, or the Russian President may be forced to change tack and again side with the hard-liners. "For the first time there is a gap between Putin and the bureaucratic consensus," says Sergei Rogov, director of the U.S.-Canada Institute, an independent think tank in Moscow. There is also a breach between Putin and the broader public, a majority of which opposes the U.S. air strikes in Afghanistan. This is an unusual spot for Putin, who cherishes the comfort of consensus.

Still, Putin is not entirely alone. He can call for backup from

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1:00 pm

Wednesday, Nov. 14
Fremont Marriott Hotel
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7:00 pm

Thursday, Nov. 15
San Jose Wyndham Hotel
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1:00 pm and 7:00 pm

Tuesday, Nov. 13
San Francisco
Hyatt Regency
5 Embarcadero Center
7:00 pm

Tuesday, Nov. 13
Oakland Hilton Airport
1 Hegenberger Road
1:00 pm

Wednesday, Nov. 14
Foster City Crowne Plaza
1221 Chess Drive
1:00 pm and 7:00 pm

Thursday, Nov. 15
Walnut Creek Marriott
2355 North Main Street
1:00 pm and 7:00 pm

BusinessWeek

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ken by President Ronald Reagan, Russia substituted a 13% tax on personal income for a complicated system of multiple brackets that many people evaded. For the first half of 2001, personal income-tax collection rose by 50%. The economy is expected to get another boost from a cut in the corporate profit tax, from 35% to 24%, a Putin initiative slated to take effect on Jan. 1, 2002. Those policy shifts will free up capital for companies bent on self-improvement. The most impressive gains have been in the oil patch. Starting in 1989, as the investment-starved Soviet economy effectively imploded, Russian oil production declined for 10 years. But in 2000, boosted by \$5 billion in capital expenditures, output rose by 5%. This year, output is projected to climb by 7.5%.

The smartest companies, such as privately held Tyumen Oil, are turning to Western energy service companies for a boost. A Russian native and veteran of BP PLC, Tyumen President and CEO Simon G. Kukes has installed a 300-plus contractor team from Dallas-based Halliburton Co. to improve the productivity of the aging Samotlor field in western Siberia. Since 1998, pre-

tax profits have doubled and are expected to reach \$1.4 billion in 2001. "Russian producers have gone from not knowing what was depleted in a field to having production software that gives them real-time information at each wellhead," says Jamie Richard, portfolio manager at Firebird Management in New York, a Russia investment fund.

More Western resources are on the way. ExxonMobil has decided to increase its \$600 million investment in its giant Sakhalin-1 oil and gas development project off the Pacific Coast by \$4 billion over five years. Greater political consensus between the U.S. and Russia may also boost the chances for cooperation in building a pipeline from the oil-rich Caspian Sea to the West. BP, main developer of the proposed pipeline from the Caspian port of Baku to Ceyhan in Turkey, is huddling with Russia's Lukoil over possible participation.

Putin is also using pressure from foreign shareholders to push for change at Gazprom, which is 38%-owned by the government. Five months ago, he ousted Rem Vyakhirev as CEO of Russia's biggest and perhaps most corrupt compa-

BOEING: IN SEARCH OF A BIG BEAR HUG

Few U.S. businesses are as well positioned as Boeing to capitalize on improved relations between the U.S. and Russian governments. Over the past decade, the Chicago aerospace giant has pumped over \$1 billion into the Russian economy, a substantial chunk of the total \$7 billion in U.S. direct investment so far. Thomas R. Pickering, Boeing Co.'s senior vice-president for international relations, was U.S. ambassador to Russia from 1993 to 1996. In April, Boeing Chairman and CEO Philip M. Condit was the first Westerner to receive the Russian Space Star, the country's highest aerospace honor.

Boeing executives view Russia as a crucial component of the company's worldwide strategy. Russia offers a deep pool of aerospace engineers and scientists at bargain prices—and a potential market for hundreds of new planes over the next 10 years. Boeing has yet to score a big commercial airplane order because most Russian airlines today can't afford to replace their aging fleets, but, ever hopeful, the company has been quietly positioning itself for such a day. "There is a rich

Aeroflot of up to 70 planes. A multibillion-dollar deal would go a long way toward keeping Boeing's production lines running during the falloff in orders following September 11. It's a long shot, though, and unlikely to happen this year. Punitive tariffs of 40% make imported planes expensive for Aeroflot. Any deal would need Putin's involvement: coughing up government funds or rolling back tariffs.

Either action is bound to generate protest in Russia, especially from the country's own beleaguered aerospace industry. That's one reason why Boeing is courting its Russian counterparts. In June, the U.S. company agreed to consider assembling a 75-seat regional jet in Russia with Sukhoi Civil Aviation. Boeing rival European Aeronautic Defense & Space Co. (EADS), too, is outsourcing in Russia. In July, it signed a \$715 million agreement with Putin to build components for Airbus jets at Russian plants.



BOEING'S DESIGN CENTER

Russia offers engineering talent—for cheap

Boeing has moved into many businesses in Russia over the past decade, from the International Space Station to a sea-based satellite-launching venture. The Boeing Design Center in Moscow employs 650 Russian scientists. In one project, Russian engineers redesigned the overhead bin for the Boeing 777, cutting the number of parts and assembly time.

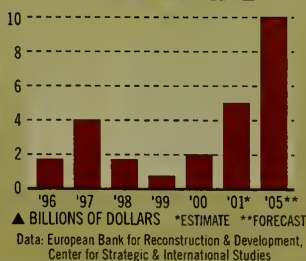
The idea of Russians taking American jobs doesn't sit well at home, where Boeing is cutting up to 30,000 staff. But

do the math and it becomes clear why Boeing execs want to triple the size of the Moscow staff. Boeing's U.S. engineering employees each earn between \$5,200 and \$6,000 a month, compared with \$400 to \$900 a month for a senior Russian engineer.

Agree or disagree with the merits of outsourcing, Russia is a model for Boeing's ambitious strategy—and perhaps a model for Moscow and Washington as they explore what Pickering calls a "mutually productive relationship." For Boeing, it still comes down to selling airplanes. The company needs to prove to investors that such a relationship can pay off for them, too.

By Stanley Holmes in Seattle, with Catherine Belton in Moscow

FOREIGN INVESTMENT IS GAINING PACE



pool of talent in scientific and engineering skills in Russia that has produced real cost-savings benefits for us already," says Condit. **LONG SHOT.** Boeing's Pickering recently returned from a trade mission to Russia. The biggest item on his agenda: discussing the possible purchase by

ny. Vyakhirev's replacement, Alexei B. Miller, a Putin associate, is backing a plan to open Gazprom's monopoly pipeline system to all gas producers at reasonable rates and is ousting Vyakhirev's cronies, despite opposition inside the company. "He is cleaning out the dinosaurs," says William Browder, managing director of Hermitage Capital Management, a Moscow investment fund.

Russia's oil and gas supplies could run out in 30 to 40 years. That's why it is essential that Putin's charm offensive lures in Western capital to help diversify the economy. With a 15% rate of annual growth, the Russian information technology business is expanding nearly three times faster than the economy: Its companies hope to peddle cheap and reliable software code, much as India's software outfits have.

Leading the way are such companies as Moscow-based Information Business Systems (IBS), whose revenues are expected to climb by 23%, to \$250 million this year. Its client roster, which includes IBM and Citibank, should grow sharply. After September 11, 10 U.S. companies, including insurance giant American International Group Inc., approached IBS about the possibility of offshore programming deals. That is not only because tighter finances mean more companies are looking for discount programming but also because India is looking less stable because of its proximity to Pakistan. "U.S. companies are looking to Russia as a way of sharing the risk," says IBS President Anatoly Karachinsky.

TECH COOPERATION. Here, too, Western assistance could be crucial. There are plans, which may be announced when Putin gets to the U.S., to create a new U.S.-Russian working group on the IT sector. Also in the works is a \$3 million joint venture between New Jersey-based M.E.C. Technology, which supplies engineering services and spare parts to the semiconductor industry, and Russian chip producer Mikron Corp., based in Zelenograd, a region Russians like to call "Silicon Meadow."

Such cooperation with the West could finally help Russia build a middle class, a crucial component for economic and political stability. As things stand, only Moscow and St. Petersburg can lay claim to a middle class of real size. Moscow, in particular, has shed its Soviet skin to become a modern European city with a professional workforce. Middle-class shoppers, for example, throng Moscow's Sportsmaster chain for running shoes, tennis rackets, cross-country skis, and other equipment. Meanwhile, because of a boom in car ownership—from 79 cars for every 1,000 people in 1991 to more than 224 per 1,000 today—Moscow's roads are clogged with Ladas, Toyotas, Audis, and Jeeps.

Provincial cities should be so lucky. Places that used to draw much of their livelihood from the Soviet military complex, such as Pskov and Murmansk in northwestern Russia, are now crime-infested ghost towns. What's encouraging is that investment is starting to move into the re-

gions. After expanding rapidly in Moscow and St. Petersburg, McDonald's Corp. is now building restaurants in cities like Rostov-on-Don. In 1997, Moscow garnered 69% of all foreign investment, but that share is down to 40%.

But aren't investors going to get their pockets picked in Russia? Stewart P. Reich, a New Yorker and AT&T veteran who now heads Russia's Golden Telecom, spends plenty of time wrangling with provincial politicians—but that's life everywhere in the global telecom market, he maintains. "Russia is not unique," he says. It's still perilous, especially for minority shareholders. Oil major Sibneft just disclosed the sale of a chunk of management-held stock to insider Roman

Abramovich. Many investors concluded the deal amounted to an interest-free loan from management to Abramovich and knocked 20% off Sibneft's share price.

Yet such outrages are happening less frequently. One reason is that Putin's regime is setting deadlines for companies to adopt global auditing rules. "We are pretty optimistic about the improvement in the business climate," says Ruth R. Harkin, senior vice-president of United Technologies, which has invested more than \$400 million in 25 projects, including a venture between Pratt & Whitney and Perm Motors.

Putin is not an unblemished leader: Just ask any Chechen family that has been savaged in Russia's war on that province. Or check with a former reporter for NTV, a critic of Putin that has been largely tamed. The question for Bush is whether Putin's agenda is on balance a positive one. Based on the record so far, the case for backing him is strong. Putin, after all, has offered more help to the U.S. since Sep-

tember 11 than any other political leader with the exception of British Prime Minister Tony Blair. To give Putin political cover to keep hardliners at bay, Washington could push to end NATO's ban on purchases of Russian weapons by member countries, suggests Stanford analyst McFaul.

Of course, Putin, for all his tactical flair, is not bargaining from a position of strength. One reason he gave the green light to U.S. bases in ex-Soviet Central Asia, Kremlin aides acknowledge, is that Russia itself, with a pipsqueak annual defense budget of less than \$8 billion, lacks the firepower to protect its soft underbelly from an Islamic insurgency.

It might be tempting for the U.S. to treat Russia as no more than a failed superpower that no longer matters. Tempting, but unwise. Not since Peter the Great chased the Swedes out of the Baltics 300 years ago has the West been able to ignore Russia for long. The country is simply too big to be cast into a corner. "We have endured much worse than anything we are facing now and have always found our way," notes Isserov, the graduate student. It's in the West's interest to help Russia on its journey.

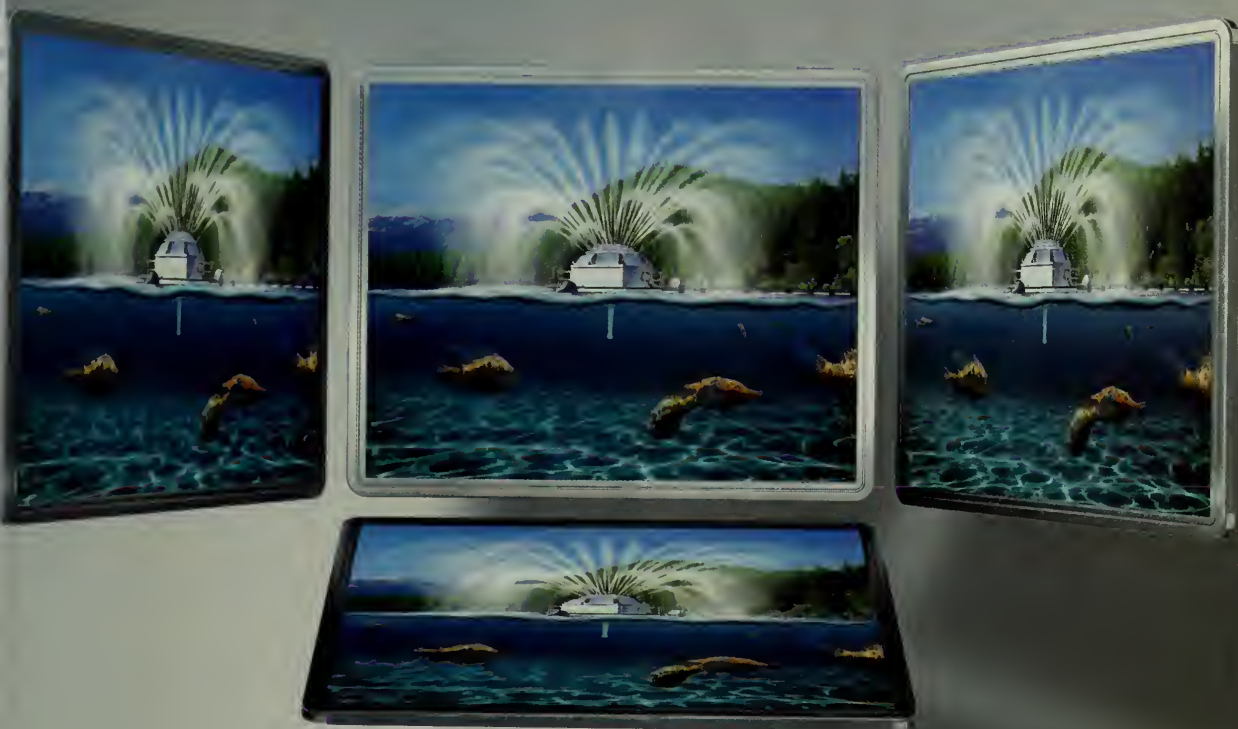
By Paul Starobin, with Catherine Belton, in Moscow, and with Stan Crock in Washington



SEEKING 'NATIONAL DIGNITY'

Student Isserov doesn't want Russia to become a U.S. clone

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WARM RECEPTION

At their first meeting in June, Bush worked on building a rapport with Putin

viding a backup oil reserve. That's why Russian and American sherpas preparing for the mid-November summit in the U.S. are working furiously to produce an historic breakthrough.

Expectations are high. For their part, the Bushies envision a chance to get the nod from Moscow for proceeding with tests for a missile defense system—one of the Administration's key foreign policy goals. In return, Bush may promise to heed Putin's request to delay any decision on scrapping the 1972 Anti-Ballistic Missile Treaty, which Putin has called "the cornerstone of nuclear peace." That would give both sides leeway to decide the treaty's fate years down the road, when missile defense—if it works—is deployed. Just as important, the Russian and American leaders could agree to slash nuclear ar-

FROM EVIL EMPIRE TO STRATEGIC ALLY

How the U.S. and Russia came to realize they need each other

When Condoleezza Rice was a staffer on the National Security Council in 1989, she once had to physically block upstart Russian politician Boris N. Yeltsin from barging into President George H.W. Bush's office. At the time, the Bush team was putting all its support behind Soviet leader Mikhail S. Gorbachev as the Evil Empire was unraveling. And Yeltsin, in the White House pushing his own reform agenda to Bush aides, made the unpardonable gaffe of trying to crash the Oval Office without an appointment. These days, as National Security Adviser, Rice would gladly give Yeltsin's hand-picked successor, Vladimir V. Putin, unfettered access to the current President Bush.

The turnabout reflects a marked evolution in Republican thinking about Russia since the USSR's demise a decade ago. During the Clinton years, the Republicans argued for distance from the Yeltsin camp, and to some extent from Russia itself. The former superpower was seen as a corrupt basket case and the erratic Yeltsin as something of a buffoon. Now, Bush's Washington sees Moscow as potentially a key player in critical areas—from fighting the war on terrorism to pro-

senals to 1,500 or 2,500 warheads—down from 6,000 in Russia and 7,000 in the U.S.

Perhaps most important for Putin, he expects Bush to endorse Russia as an important post-cold war ally and a major player again on the global stage. That status, after a decade of humiliation in the wake of the USSR's collapse, could help restore a sense of national pride to Russia and enhance Putin's stature as leader. "Putin from the beginning grasped this as an opportunity to redefine the entire relationship," says a senior Bush Administration official. The Administration is expected to throw away relics such as the 1970s' Jackson-Vanik trade restrictions, imposed when Soviet Jews weren't allowed to emigrate.

TWO-PRONGED ATTACK. The Bush-Putin summit in Washington and Crawford, Tex., was planned long before September 11. But the terrorist attacks on the U.S. transformed the prospects for U.S.-Russian relations. Suddenly, Administration officials realized "they need Russia in a way they didn't dream they needed Russia," says Robert Legvold, a Columbia University political scientist and Russia expert.

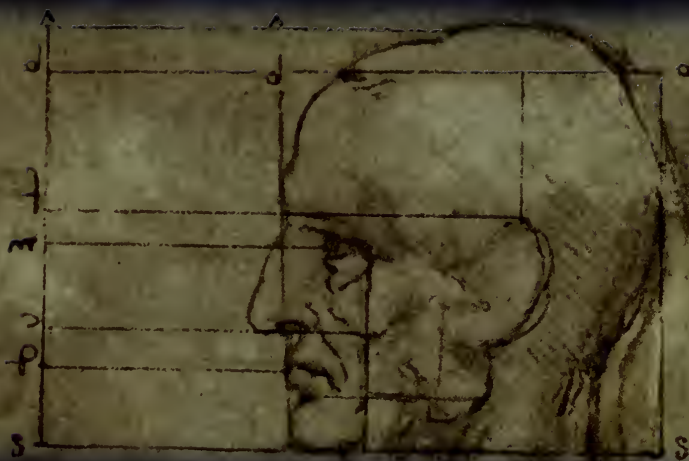
Even so, the thinking for a major reshaping of the globe's strategic

Bush not only endorses Putin's stature as a leader but reassures Russians that they are still major players on the world stage

SPECIAL REPORT



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SPECIAL REPORT

RUSSIA

landscape began years before that terrible day. The roots of the idea go back to Ronald Reagan and his ambitious Star Wars, or Strategic Defense Initiative, which never really got off the ground but nonetheless helped spur Gorbachev to launch reforms in the Soviet Union. And they also date to 1991, when then-President Bush and Gorbachev signed the second U.S.-Soviet Strategic Arms Reduction Treaty, which called for slashing nuclear arsenals to 3,500 warheads on both sides. That treaty wasn't ratified until last year and has never been implemented.

Meanwhile, the moribund Star Wars project got a new lease on life. In 1998, now Defense Secretary Donald H. Rumsfeld led a government commission that concluded that the threat of a missile attack from a rogue state such as Iraq could become real in a few years. That put pressure on the Clinton Administration to channel funds into limited research on missile defense. Then, in early 2000, Rice echoed Rumsfeld's views in an article in *Foreign Affairs* magazine. She proposed that the next Administration follow a two-pronged approach: missile defense plus drastic cuts in nuclear arsenals.

Bush had already tapped Rice as his campaign's foreign policy adviser. On May 23, 2000, at a speech at the National Press Club in Washington, he laid out his vision for a post-cold war relationship with Russia. "Russia itself is no longer our enemy. The cold war logic that led to the creation of massive stockpiles on both sides is now outdated," he declared. During the campaign, Bush also made it clear that he considered the ABM treaty obsolete. And if Russia didn't want to come along, the President would walk away from the treaty. Once in power, senior Bush officials continued to talk tough about missile defense, despite opposition from Putin as well as leaders in Europe and China. Rumsfeld

DEACTIVATING WARHEADS

Bush has declared the cold-war logic of massive stockpiles "outdated"

even called Russia "a part of the [nuclear proliferation] problem."

Then, in the spring, the Bush team's tone suddenly changed. Some

senior officials argued that the Administration should pay more attention to European criticism of U.S. policy, while a State Dept. policy review concluded that the Administration ought to deal more with Russia on issues ranging from Caspian oil to Iraqi sanctions. "The Administration realized that while Russia is not a central player in everything, it still is an important country," says Angela E. Stent, an expert in the State Dept.'s policy planning office until July. In a May 1 speech at the National Defense University, Bush decided to reach out, declaring that "Russia and the United States should work together to develop a new foundation for world peace."

When Bush finally met Putin for the first time on June 16 in Slovenia, the ice not only thawed—it evaporated. Overriding skeptical advisers, Bush decided to build a rapport with Putin and persuade him his Administration truly wanted to leave the cold war behind. That effort paid off after September 11, when Putin called Bush and offered his support in battling Osama bin Laden.

TENSION AT HOME. So where could the U.S.-Russia relationship go from here? The possibilities include not just nuclear cutbacks and business deals, but the chance to replace one-time superpower rivalry with a lasting alliance to fight terrorism or other global problems. Of course, tensions will arise. At home, Putin must face down hardliners wary of his new friendship with the West. And Washington's conservatives will have to accept the fact that Putin could still do things they don't like—such as sell arms and technology to China or Iran.

In the short term, though, there is reason to be upbeat. As the U.S. and Russia become allies determined to defeat the same foe, their political and economic interests are starting to converge. That's entirely different from the climate when the two nations joined forces in World War II. Maybe, after the war on terrorists, Russia and the U.S. can enjoy a kind of peace that will finally banish the memories of cold war.

By Stan Crock in Washington

RETHINKING THE RELATIONSHIP

Russia is emerging as a strong ally to the U.S., but sources of tension remain

COOPERATION

THE WAR AGAINST TERRORISM

The effort provides the two nations with shared strategic interests for the first time since World War II.

ECONOMIC DEVELOPMENT

Putin has pushed through the Duma a broad array of reform legislation that could make U.S. investments in Russia much more attractive.

NUCLEAR STRATEGY

Both sides want to slash nuclear arsenals dramatically, and an agreement could give Putin political cover to O.K. expanded U.S. testing for a missile shield.

CONFRONTATION

WEAPONS PROLIFERATION

The U.S. objects to Russian arms sales to China and its transfer of nuclear power technology to Iran.

HUMAN RIGHTS

Washington doesn't want the fight against terrorism to be used as a cover for clamping down on political dissidents in Chechnya or the media.

MISSILE DEFENSE

An interim deal may be done in Washington, but Moscow still fears the Bush Administration's missile shield could upset the arms control regime that has ensured peace.



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ACQUISITIONS

WHERE DO THE BIG DOGS GO FROM HERE?

EchoStar's DirecTV deal has everyone reassessing strategy

It was a telephone call between titans. On Oct. 27, Rupert Murdoch, at home in New York's SoHo district, rang up cable-programming magnate John C. Malone at his suburban Denver ranch. Minutes earlier, Murdoch had pulled out of the bidding to buy satellite-TV operator DirecTV from General Motors Corp. His conversation with Malone was much friendlier. "They were two guys who had just lost a big one," says a source close to both men. "The next thing out of Malone's mouth was, 'Where do we go from here?'"

Where indeed? The deal by Charlie Ergen's EchoStar Communications Inc. to buy DirecTV for \$24.6 billion has significantly reshuffled the ambitions of Murdoch's News Corp. and Malone's Liberty Media Corp., which had joined Murdoch's bid for the TV service. But it may generate aftershocks well beyond them, elsewhere in Media Land.

NIGHTMARE. Cable giants such as AOL Time Warner Inc. and content providers such as Walt Disney Co. are likely to reexamine whether they have the size to compete in the fast-consolidating media landscape. The battle over AT&T's cable unit may also heat up. Other deals will likely follow. "Having one player [a combined DirecTV/EchoStar] out there with 16 million subscribers tends to make everyone look at their hand again," says Peter Kreisky, a media consultant with Mercer Management Consulting Inc.

What's more, Ergen has proven to be a competitor's worst nightmare,

willing to undercut cable rates, for example, to gain market share. Just weeks before the GM deal was struck, Ergen had mixed it up with cable operator Charter Communications Corp., which charged EchoStar with deceptive advertising over its \$9-a-month TV package. Ergen denied the charge. With EchoStar and DirecTV under one roof, Ergen has said he could cut more than \$500 million in overhead, offer more local signals, and continue to charge lower subscription fees.

Another reverberation of the DirecTV deal is that new attention is turning to AT&T's 14-million-subscriber cable unit,

the largest block of subscribers still on the market. Although AT&T has hinted that it may take down the "For Sale" sign, some industry sources believe that's a ploy to wrangle a higher price for its long-struggling subsidiary. Comcast Corp. is contemplating increasing its \$40 million bid for the unit, say Wall Street sources. More recently, Cox Communications Inc., the nation's No. 5 cable operator, has begun sounding out potential partners to make a counteroffer. Neither Comcast nor Cox would comment. AOL Time Warner, which had all but taken itself out of the running, is again pondering buying some or all of it, says a source close to the company. Rumor mills have been buzzing that Malone, who sold the cable assets to the telephone company just two years ago, may regroup and join with another company to get them back.

COSMIC IRONY. Right now, Ergen has his work cut out for him. The day after announcing the deal, he was already cozying up to legislators and antitrust regulators who might yet unravel his plan to merge the No. 1 and No. 2 satellite companies. But a far bigger problem may be shareholders of DirecTV parent Hughes Electronics Corp. Its stock has fallen nearly 14% since the deal was announced, which may yet force Ergen

to sweeten his offer. To complete the financing, Ergen says he would be willing to look for strategic partners.

Therein lies the cosmic irony. The guys with the hot money right now are Malone and Murdoch. Murdoch has flirted with Ergen before, but the attempted merger between News Corp.'s satellite unit and EchoStar ended in a \$5 billion lawsuit brought by Ergen. Is a new accord bringing Murdoch and Malone into Ergen's DirecTV deal only a telephone call away?

By Ronald Grover in Los Angeles, with Tom Lowry and Steve Rosenbush in New York

The Players



CHARLIE ERGEN

After winning his come-from-behind offer to buy DirecTV, the onetime pro card player needs \$2.7 billion and wants "strategic partners."

RUPERT MURDOCH

He got beat out on DirecTV, but he still needs U.S. distribution for his Fox sports, news, and other channels. May invest in Ergen's EchoStar.

JOHN MALONE

Planned to hitch along when Murdoch bought DirecTV. Now, Malone's Liberty needs a new vehicle to bring his programming to U.S. viewers.

BRIAN ROBERTS

Comcast's surprise bid to buy AT&T cable is mired in three-month-long talks. Roberts may need to look elsewhere for growth.

PAUL ALLEN

With nearly 7 million subscribers, his Charter cable company is an attractive partner for consolidation. If AT&T jilts Comcast, Roberts may call Allen.

WE AT DREYFUS ARE PROFOUNDLY SADDENED BY THE TRAGIC EVENTS OF SEPTEMBER 11TH.

Our thoughts and prayers are with those injured and lost, and their families and friends.

We are eternally grateful to the New York Police and Fire Departments, and all others involved in the heroic rescue and recovery operations. Together we shall rebuild. But never forget.



A MELLON FINANCIAL COMPANY

HOLLYWOOD

LOOKING FOR A FEW GOOD BLOCKBUSTERS

Media companies need holiday hits more than ever

One of the surprise hits of Hollywood's holiday season may be a film that was never intended for the Christmas lineup. When Metro-Goldwyn-Mayer Inc. pulled its World War II movie, *Windtalkers*, from a Nov. 9 debut because of the September 11 terrorist attacks, Warner Bros. Inc. pounced on the open weekend for its David Mamet-directed film, *Heist*, a thriller about thieves starring Gene Hackman and Danny DeVito. "All of sudden, a film no one had heard much about looks like it could find an audience," says Paul Dergerabedian, president of box-office analyst Exhibitor Relations Co.

Indeed, holiday movies—in theaters, on video, and on DVD—may be all the media conglomerates have going for them during the fourth quarter. A deteriorating economy, exacerbated by post-attack woes, has cut the advertising, subscriptions, and other revenues so important to big media companies, badly denting their sales and earnings forecasts for the year. The last glimmer of hope: yearend movies, which normally account for 20% of a studio's annual box office.

REBOUND. This year could offer bigger gifts. Movie audiences are shaking off a year-long funk, with their numbers running nearly 10% ahead of 2000. In the five weekends since September 11, the studios have topped last year's box office for those dates. Dergerabedian predicts a record \$8 billion in ticket sales for the year. "People need to get out of their houses, away from CNN, and we think they're gonna want to see movies," says Tom Sherak, a



SLUMP SYNERGY
Disney will use canceled ad time on its ABC unit to run spots for its *Monsters Inc.*

partner at indie outfit Revolution Studios.

That rebound has Hollywood feeling all the more urgency to cash in now. One example: Sources say Revolution is considering moving up the release of its big-budget military film, *Black Hawk Down*, from next March. And studios are hustling to fill slots left open this season by Hollywood's wariness of Warner Bros.' much-anticipated *Harry Potter and the Sorcerer's Stone*, opening on Nov. 16. Fewer choices could

help the Walt Disney Co.'s computer-generated *Monsters Inc.* and Fox's Martin Lawrence comedy, *Black Knight*, opening the week after *Potter*, positioning itself as an alternative to teens turned off by the precocious wizard.

Studios are also hoping for a big boost from DVD sales, especially among folks ensconced at home during the holidays. Paramount is releasing *Lara Croft: Tomb Raider*, and Universal is offering *Jurassic Park III* in the next few weeks. With players now in nearly 25 million U.S. homes, analyst Tom Adams of Adams Media Research thinks DVD sales plus videos will generate revenues of \$9.6 billion for studios this year, vs. \$8.1 billion last year.

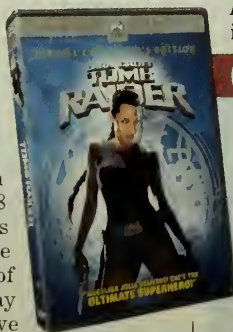
Among those expecting a big final quarter is AOL Time Warner Inc. In addition to releasing *Harry Potter* and *Ocean's 11*, a star-studded remake of the '50s Rat Pack movie, it will roll out the eagerly awaited first installment of *Lord of the Rings* through its New Line Cinema. The movie and DVD releases could mean \$183 million in cash flow for Warner Bros.' fourth quarter, a 47% hike

over last year, figures ABN Amro Inc. analyst Spencer Wang, beating AOL's Internet, cable, and publishing units. Other studios may post healthy years, too: Wang projects 25% cash-flow growth at News Corp.'s Fox Entertainment and 18% growth for Viacom's entertainment unit.

Some of those earnings will come from cost-cutting and the stockpiling of movies in anticipation of a Hollywood strike that didn't materialize. More recently, some studios have been trimming back on lavish premieres.

But they won't be cutting advertising, especially with ad rates falling as advertisers pull out of agreements. Disney says it will use some canceled ad time on its ABC unit to run spots for *Monsters* and a DVD release of its classic *Snow White and the Seven Dwarfs*. Adds Michael Dunn, Fox Home Entertainment's marketing chief: "We've got the same budget. We're just able to buy a lot more ads with the same amount of money." The irony is that the movie business, long criticized for its spendthrift ways and hit-or-miss risk, is suddenly the stalwart earner in an otherwise dismal media landscape.

By Ronald Grover
in Los Angeles



HIGH HOPES FOR NEW DVDS

CAN MOVIES PICK UP THE SLACK?

Clobbered by a slow economy and falling ad sales, media giants are counting on their studios

ESTIMATES, 2001

COMPANY	STUDIO REVENUE GROWTH	CORPORATE PRO FORMA REVENUE GROWTH
AOL TIME WARNER	8.6%	5.6%
FOX ENTERTAINMENT*	9.9	8.2
VIACOM**	3.0	0.5
WALT DISNEY	4.0	0

* Current fiscal year ends on June 30

** Includes Paramount Pictures, Paramount theme parks, and Famous Player Theaters

SOURCE: MERRILL LYNCH

Smart Cars



Electronic devices have been seeping into cars since the radio moved on board 80 years ago. Today they're much more than just handy gizmos to entertain you.



Modern vehicles simply can't function without electronics, which now account for about 15% of the cost of a new vehicle.

That's because even the least expensive economy car today uses a computer to control its engine. You'll also find electronics inside such devices as the air conditioning, speedometer, automatic transmissions, and more. Toyota figures there are about 80 microprocessors in a typical car these days.

By the end of this decade, electronics will claim up to 40% of a vehicle's value, according to a recent survey by *Automotive Industries* magazine. Much of the increase will come through the more general use of features that drivers can see, feel, and hear—things like navigation aids and hands-free phones.

At least the same proportion will be generated by the growing adoption of behind-the-scenes systems, many of them operating automatically without any input from the driver, that make motoring safer, smoother, and more comfortable.

Three factors are fueling the jump in onboard technology: new safety standards, tougher rules about exhaust emissions and fuel economy, and the rise of telematics—electronic services that wirelessly connect your car with the outside world.

More Power!

It will take more electrical power to operate all these onboard electronic devices. Power-hungry but fuel-saving features such as electric steering will add to the demand.

Industry forecasts say some cars will consume up to 5,000 watts of power to operate all their features by 2005. The average car needed only 650 watts to run everything in 1970. Last year's average: 1,000 watts.

To ease the power drain, automakers are inching toward vehicles than run on 42 volts, three times the current level. Rewiring an entire car for that much power is a big job, and it won't happen quickly. The first dual-voltage cars are due in about two years in Europe. They will be rigged to operate light bulbs and other low-voltage systems on one power circuit and more power-draining features on another.

Standard & Poor's DRI, a division of McGraw-Hill, projects up to 35% of all cars and light trucks built in North America, Europe, and Japan will have 42-volt electrical systems by 2010.

TELEMATICS

Nothing is hotter among automotive planners these days than telematics. They figure up to 50% of all new cars and trucks will carry some form of telematics capability by 2006.

The demand will create a huge new industry for telematics hardware and services. Consultants Frost & Sullivan expect a \$7 billion market by 2007 in North America alone. It thinks telematics in Europe will be just as big. Other experts see global demand for telematics reaching \$47 billion in 10 years.

Exactly what form telematics will take is not yet clear, so automakers are testing the market carefully. "Customers will decide what services they want," notes Wolfgang Bernhard, chief operating officer of the Chrysler Group of DaimlerChrysler AG.

What can telematics do? Consider these scenarios for the not-too-distant future:

- You're running errands that includes a trip to the video store. Before you get there, your car contacts the store, finds out about available new releases in the genres you prefer, and offers to reserve them for you.

- You have more than a quarter-tank of gas left, but your engine is nearly a quart low on oil. Your car checks on fuel prices at five gas stations within two miles of your present location. It reports the prices, reminds you that your engine needs oil right away, and presents a video display showing where each station is located. It also notes that one station is having a special on oil changes and could do the work immediately if you stop in now.

- When it's time for a tune-up, your car contacts your dealership's service department automatically, checks for available times and, after comparing possible appointments with the personal schedule in your handheld organizer, offers you three dates. It also canvasses other area dealerships and alerts you if one is offering a better rate. When you select a preferred date, your car downloads the information into your organizer and begins reminding you two days before the appointment.

- You and several friends are driving separately to a dinner spot. But plans suddenly change and you need a new venue that can handle your group of 10 an hour from now. Your car checks availability at six restaurants within 10 miles, reports that two could handle your group, and lets you confirm the reservation. Then it contacts your friends and supplies each with individualized audio driving instructions to the new meeting spot from each of their present locations.

The technology exists now to make these and many other conveniences a reality. Drivers whose cars are equipped with OnStar, the onboard information service launched by General Motors Corp., are getting a good taste of the potential of telematics with OnStar's new Virtual Advisor service. It offers customers a growing menu of voice-activated services that includes the ability to trade stocks, get news bulletins, have e-mail messages read, and get updates on everything from tonight's TV listings to celebrity gossip.



OnStar, the onboard telematic information service offered by General Motors, serves more than one million customers.

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(501)



OnStar also can locate your vehicle and alert nearby emergency services if your airbags deploy, remotely unlock your doors for you if get locked out, diagnose engine problems from afar, and track your vehicle if it's stolen.

Other automakers are beginning to add similar capabilities to such telematics services as Ford's RESCU and Mercedes-Benz's Tele-Aid. But OnStar, which surpassed one million customers last spring, has a commanding lead.

The Distraction Question

Can people benefit from telematic services and still keep their mind on the road? If recent consumer surveys about cell phone usage in cars are any indication, regulators and the public need convincing.

Roughly three out of four Americans think it's too distracting to talk on a cell phone while driving—even though most do so anyway. Surveys show half the population supports an outright ban on using handheld cell phones in moving cars. At least 40 states are pondering cell phone restrictions of some sort for vehicles.

Automakers are convinced there's a way to offer drivers telematic services, including phones, that "manage" their potential for distraction. Voice-activated controls are one approach. Preliminary research by safety experts suggests drivers can process plenty of input if it's not all presented at the same time. One idea: telematic systems that know not to interrupt with an announcement when, for example, a driver is negotiating a turn.

Voice-activated controls will be a common feature in these systems. GM's OnStar says its hands-free service has recorded only two accidents occurring during 8.1 million customer calls over 2 1/2 years—neither involving driver distraction.

Satellite Radio

Would you pay around \$10 per month to receive 100 radio channels in your car—many with no commercials—no matter where you drive across the continental United States?

A pair of services just now being rolled out hope your answer is "yes." XM Satellite Radio and Sirius Satellite Radio are just beginning to beam their unique mixes of music,

sports, news, and talk radio programming across the country from satellites parked 22,300 miles above the United States.

You need a special digital receiver to pick up Sirius and XM signals. Aftermarket satellite radios are available now, and automakers will begin offering factory-installed units in volume next year. For now, the hardware to receive one company's service isn't compatible with the other.

SAFETY

Electronics can be a big help in making cars and trucks safer. Antilock brakes, now standard on most vehicles, is a case in point. So, too, are those optional sensor systems that mount on the rear bumper and look for objects behind your vehicle when you back up.

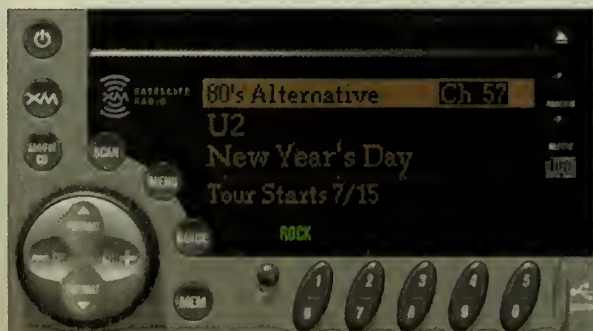
Sophisticated stabilization systems that improve vehicle handling during emergency maneuvers—a particularly attractive feature for high-riding sport utility vehicles (SUVs)—also are beginning to sweep the marketplace. They automatically and almost instantly adjust the suspension, apply the brakes on a wheel-by-wheel basis as needed, or even slow the engine automatically to keep you in control.

Land Rover's "active cornering enhancement" system uses sensors, a two-part anti-sway bar, and fast-acting hydraulic cylinders to eliminate virtually all body lean during brisk turns. Cadillac's third-generation StabiliTrack system, which General Motors calls the most advanced integrated stability control system in the world, fine-tunes steering effort and continually adjusts each wheel's brakes and shock absorber to improve vehicle stability and control. It even monitors road texture to ensure maximum performance for the antilock braking system.

Only about 3% of vehicles built in North America have stability enhancements now. But that could grow to 21% by 2008, says Tier One, an automotive electronics research company in Mountain View, Calif.

Tire Pressure Sensors

Today you can buy a handful of cars and trucks equipped with devices that monitor tire pressure and let you know when a tire is going flat. By November 2003, a new federal safety standard is expected to require all new cars and trucks sold in the U.S. to have these handy systems to



XM Satellite radio plans to begin nationwide service of all-digital sound starting November 15, 2001.



A direct tire-pressure monitoring system will be available this fall on the 2002 Jeep Grand Cherokee.



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Answers for questions to come.



tell you when a tire is 20% or more below normal pressure.

Air pressure sensing systems were mandated by the U.S. Congress after last year's Firestone tire recall program called attention to the importance of maintaining the correct tire pressure in vehicles, especially SUVs. Low tire pressure reduces fuel economy, diminishes vehicle handling, and makes a tire run hotter and thus more prone to failure.

Pressure sensors are a good idea, since about 36% of cars and 40% trucks on the road right now have at least one tire 20% underinflated, according to the U.S. National Highway Traffic Safety Administration.

Tire pressure sensors will keep track of the correct air pressure for you and let you know with a warning light when one or more tires drops well below safe levels.

This fall, for example, Chrysler will become the first automaker to introduce direct tire pressure monitoring systems for sport utility vehicles and minivans. Its system will be available on 2002 Jeep Grand Cherokee, Dodge Grand Caravan and Chrysler Town & Country minivans, and the Chrysler 300M sedan.

Airbags That Think

Airbags can be very effective in protecting passengers in a crash. But until now, they have been set up to inflate blindly when they detect a crash—with a fixed amount of force and whether anyone is sitting in front of them or not.

That's changing, thanks to new federal airbag test standards. Now carmakers are beginning to install airbags that choose one of two inflation rates depending on the severity of crash and whether occupants are wearing seatbelts.

Next up: airbag systems that decide if, when, and how hard to inflate after sensing the size, weight, and seating position of occupants. These smart airbags may decide not to deploy the front passenger position if no one is there or they detect a rear-facing child seat in that area.



Delphi Automotive Systems "Smart" airbag can sense an occupant's position and weight.

Airless Tires?

One way around the safety concerns of underinflated tires would be to use tires that still perform well with little or no air inside.

Michelin's PAX System is one. It has a plastic insert so the tire keeps its shape if air leaks out and a special wheel-tire mounting mechanism that won't let the tire come off the wheel rim if there's a blowout. It also offers better fuel economy and more cornering power than a conventional tire. Drawbacks: PAX tires cost more and only fit on wheels designed specifically for them.

Michelin invented the PAX configuration, but it's also being licensed by Goodyear, Pirelli and Sumitomo. Look for the first PAX-equipped cars later in the 2002 model year.

What about tires that don't require air in the first place? Goodyear and Amerityre Corp. are working on a way to mold solid car and truck tires out of foamy urethane. Amerityre makes them now for bicycles and garden tractors. The two companies say they could be ready to introduce cheap, color-coordinated urethane car tires by 2004.



Michelin's Pax System has a polyurethane insert so the tire will keep its shape if there's a blowout.

Quick-Turn Artist

Big pickup trucks and full-size SUVs can be tough to maneuver in tight parking situations. But not with QuadraSteer, a four-wheel steering system debuting this fall on the GMC Sierra Denali full-size pickup. Developed by Delphi Automotive Systems, it combines improved stability at high speeds with noticeably more pronounced nimbleness at low speed.

At low speed, QuadraSteer turns the rear wheels up to 12° in the opposite direction as the front wheels for tighter turns during parking maneuvers. On the highway, the system steers the rear wheels in the same direction as the fronts to improve stability during lane changes, and, if there's a trailer in back, sharply reduce trailer sway.



QuadraSteer, a four-wheel steering system developed by Delphi Automotive Systems, debuts on the 2002 GMC Sierra Denali.

ENVIRONMENT

The debate appears pretty much over about whether global warming is real. It is. But what to do about it? There is no consensus, but one thing is clear: The heat is on to make cars and trucks cleaner and more fuel-efficient.

Exhaust emissions and fuel economy are closely linked because carbon dioxide is produced whenever fossil fuels—those containing carbon—are burned. Consume less fuel and you produce less carbon dioxide.

U.S. standards haven't changed yet, but Congress is considering updates the country's 20-year-old corporate average fuel economy standards that could boost current rules from 27.5 mpg to as high as 40 mpg in 10 years.

A woman with dark hair is shown from the chest up on the left side of the frame, looking towards the camera. The background is a night cityscape with lights, overlaid with a glowing, futuristic, yellow-green grid pattern that suggests advanced technology or a digital interface. The sky is dark with some clouds.

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The First Wave: Hybrids

Automakers aren't about to abandon the gasoline-fueled piston engine anytime soon. They are looking for enhancements, however. The easiest next step is a hybrid drivetrain that combines the advantages of gasoline and electric power.

Hybrids have a piston engine generally used for cruising and an electric motor for starting up and when extra power is required. The piston engine also recharges onboard storage batteries on the fly, so a hybrid—unlike an all-electric vehicle—doesn't need tedious recharging.

Honda and Toyota have been testing U.S. demand for gasoline-electric hybrids for nearly two years with the tiny two-seater Honda Insight and subcompact four-door Toyota Prius. Both cars are selling well, but neither aims at the real heart of today's American vehicle market: trucks. GM, Ford, DaimlerChrysler and others will begin to introduce hybrid trucks and SUVs in about two years from now.



The Dodge PowerBox hybrid concept SUV is a super ultra low-emission vehicle that combines an electric motor with an engine that runs on compressed natural gas.

A Comeback For Diesels?

To Americans, diesel engines are smelly, noisy, sooty, and underpowered. That image may have been true 20 years ago, but it certainly isn't accurate today.

In Europe tough emission standards and high fuel economy demands are the norm. About one-third of new vehicles sold there, including many luxury cars, are diesel-powered.

Experts say the same diesel craze could hit the United States. But it won't happen until after cleaner diesel fuels become available in about 2006.

Fuel Cells

The auto industry's holy grail for vehicle emission control is the hydrogen-powered fuel cell. It's powerful, quiet, efficient, and essentially non-polluting. Technical issues remain, but efforts to overcome them are growing very rapidly.

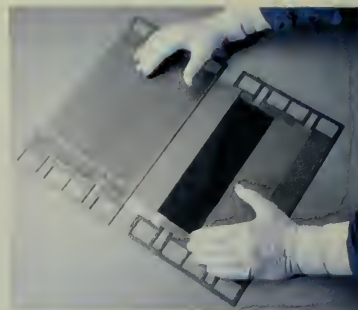
Fuel cells "burn" hydrogen and oxygen to produce electricity, leaving behind nothing but water vapor. Fuel cells are the ultimate clean, renewable power source.

Unfortunately, refueling vehicles that burn hydrogen is an obvious problem. Even optimists concede it could take decades to

convert our fossil fuel-based network of gas stations into one that delivers hydrogen.

Nevertheless, automakers are planning to begin selling a few thousand fuel cell-powered vehicles by about 2003. The first ones will run on pure hydrogen stored in onboard tanks. General Motors and other automakers are developing devices that can extract the hydrogen from gasoline.

By 2011, the industry will be building up to 2.4 million fuel cell vehicles annually, predicts a study by Allied Business Intelligence, a technology research company in Oyster Bay, N.Y.



The key elements of the GM fuel cell stack are the bi-polar plates and membrane electrode assembly, which processes hydrogen to form water.

Smarter Transmissions

You could squeeze at least 10% better fuel economy from today's cars and trucks if they had transmissions that adjusted continuously rather than stepping between four, five or six gears as conventional transmissions do.

Continuously variable transmissions (CVTs) do just that. They have been used in small European cars since the 1950s and are catching on in Japan. Best-suited for small engines with limited torque, CVTs haven't been robust enough to handle the greater power of typical American vehicles until now.

Saturn's new sport utility vehicle, called the VUE, debuts this fall with a CVT. GM plans to expand its CVT program over the next few years. Meanwhile, Ford is gearing up to produce as many as 1 million CVTs by 2005.



Saturn's new sport utility vehicle, the VUE, offers a continuously variable transmission instead of a conventional automatic.

SENSIBLE TECHNOLOGY

The current tidal wave of new technologies isn't sweeping through the auto industry because carmakers love gizmos. It's happening in large part because these technologies are the most cost-effective way to meet new safety, emission, and fuel economy standards. ○

For more information on Special Advertising Sections, contact Stacy Sass McAnulty at 212-512-6296 or stacy_sass-mcanulty@businessweek.com.

Bill Hampton, who has covered the auto industry for 30 years, writes AutoBeat Daily, a newsletter for auto industry executives.

DEFENSE

PLANES THAT KNOW WHAT TO BOMB

Smart robotic jet fighters may be delivered by 2008



RIGHT STUFF?
Critics question the wisdom of putting so much trust in software

For a fighter pilot, no mission is more dangerous than a Wild Weasel. To flush out hidden surface-to-air missiles in the early days of a war, the first jets into enemy airspace advertise their presence while trailing fighters lock on to the SAM targets and take them out. But in Afghanistan, the U.S. had a trick up its sleeve: In place of fighter pilots, it sent in small, remote-controlled Predator drones—originally designed for reconnaissance but now armed with Hellfire antitank missiles.

The Predator ploy is just a crude foreshadowing of what lies ahead. By the end of the decade, the military could be sending the first true robotic warplanes into battle. These autonomous weapons-on-wings would sniff out hidden enemy

air defenses before human-piloted fighters or bombers ventured into enemy airspace, deliver up to 3,000 pounds of smart bombs and missiles, and even take on enemy fighter jets. Called unmanned combat air vehicles, or UCAVs, their presence is likely to redefine the role of warplanes—and even warfare itself—by giving machines more responsibility for attacking enemy targets.

For six years, the U.S. military has employed drones called Predators—and more recently, Global Hawks—to spy on enemy forces. And for at least two decades, it has relied on cruise missiles. These are flying bombs that hug the ground to avoid radar as they near a pre-programmed target, then use smart imaging systems to lock on to the target and make necessary final-course correc-

tions. But UCAVs take the technology to new heights: For the first time, military leaders will send into combat machines that, in theory, could choose their own targets, decide whether to destroy them, and figure out when to return to base. Many military experts consider this next wave of technology inevitable. Ever-improving silicon smarts will make it both feasible and affordable—and airplane designers are itching to create fighters that can outmaneuver any human pilot. Already, fighters such as the F-16 can turn so sharply that pilots would black out without special flight suits that maintain blood flow to the brain.

The technology has a dark side, however: While UCAV prototypes such as the X-45A are impressive feats of engineering, they also reflect the military's increasing reliance on machines to analyze and act on the information that it gathers—a trend that disturbs some experts. "I worry that

human intelligence analysts will become so overwhelmed by data that they'll grow excessively reliant and overly confident of computers picking the targets," says John Pike, a defense analyst for GlobalSecurity.org.

CHEAPER, TOO. Despite such worries, most defense experts predict that UCAVs will eventually supplant piloted fighter jets, including Joint Strike Fighters. These are advanced first-strike aircraft that can evade radar, which the military plans to fund to the tune of \$200 billion over the next 25 years. UCAVs boast at least three advantages over JSFs: They can fly extended missions for more than 24 hours, where the limiting factor often is pilot endurance. And at just \$10 million to \$15 million a plane, they'll be a third as expensive as a new JSF fighter and cost just two-thirds as much to operate and maintain. And, of course, no U.S. pilots are put in harm's way. "UCAVs are potentially the most potent long-term competition for the Joint Strike Fighter," says a recent report by Merrill Lynch & Co. analyst Byron Callan, who predicts that UCAVs could cut into future orders for JSFs.

UCAVs are an outgrowth of the military's longstanding focus on "information superiority." This concept hinges on dramatic advances in information technology, including "faster processing, multiple satellites, and fast linkups," says Boeing Co. Phantom Works President George K. Muellner, a former Air Force lieutenant general who directs the plane-maker's UCAV work. Eventually, Muell-

You're about to stick your neck out on c





er decision that will finally update your data center. The problem is, it's hard enough predicting what will happen next quarter, let alone next year. So how can you be confident that the infrastructure choices you make today are choices you can live with tomorrow?

One option now has to include the new HP server rp8400—a rack-optimized breakthrough designed specifically to help you manage the enormous infrastructure demands generated by today's constantly evolving business environment.

It's small enough to fit two to a rack yet provides unprecedented power and flexibility in a mid-range server. In fact, we've made room for up to 16 processors, setting new standards in the category for both performance density and scalability. The kind of power you need to more easily manage and control workload allocation.

Best-in-class dynamic partitioning essentially divides the server into sections, allowing each one to function independently. So even if one application goes down, the other sections of the server continue their jobs unaffected. Which makes it possible to move resources around without having to shut down your entire system, sidestepping costly downtime.

And with the convenience of HP Utility Pricing, processing power and other services can be made available on tap, like electricity. So you can easily and securely scale online without having to invest in expensive hardware or support.

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Infrastructure: it starts with you.



ner predicts, every element of warfare will be linked to a communications web that can be visually displayed on monitors at a command-and-control center, either airborne or on the ground. Smart machines will analyze and distribute the information in real time toUCAVs, tanks on the ground, or manned fighter jets.

Under this framework, machines will play a bigger role in integrating the information than they do today. But even thoughUCAVs will have the capability to make their own decisions, a human will give the final O.K. to drop bombs, according to an Air Force brigadier general who heads the unmanned air vehicle program. "It's not our intent to have robots flying in the air automatically dropping weapons without human control," he says.

HOW SMART? Such statements don't allay all the fears swirling around theUCAV concept. One sore point with critics such as Human Rights Watch in Washington is the planes' ability to identify targets and make last-minute corrections if the situation on the ground changes. That's a challenge even for human pilots—witness U.S. warplanes that have twice, tragically, dropped bombs on an International Red Cross building in Kabul. "The more combatants are removed from one another, the greater is our concern," says Joost Hiltermann, executive director of the arms division for Human Rights Watch.

There's reason for concern. Crucial identification systems, such as automatic target recognition, have yet to prove their reliability. Using a combination of sensors, high-speed algorithms, and artificial intelligence, these systems are supposed to imbueUCAVs with enough smarts to distinguish a school bus from a tank or a weapons depot from a food shelter. But Glenn Buchan, a senior defense analyst for Rand Corp. and author of a classified study onUCAVs, is skeptical. Such technology, he says, has "notoriously under-achieved" in simulations of combat con-

ditions. And given the hurdles in getting computers to distinguish real targets from false ones, reliability flaws will continue for at least a decade. "It's an extraordinarily challenging and controversial issue," Buchan says. "We're not very far along."

This view is endorsed by Peter G. Neumann, principal scientist at SRI International Computer, a Palo Alto (Calif.) nonprofit research center and author of *Computer-Related Risks*. Routine banking software has come a long way in terms of security and reliability, but creating dependable systems for au-

fired at Taliban targets by operators directing the mission from U.S. bases thousands of miles away. (The military won't comment on these raids.)

Built by General Atomics Inc. of San Diego, the Predator is designed to circle over a target at about 20,000 feet while its cameras record everything that moves. It has been used for intelligence-gathering in Kosovo and in no-fly zones in Iraq. Earlier this year, in a test at Nellis Air Force base in Nevada, a Predator with a Hellfire missile successfully blew up a tank.

LONG HAUL Afghanistan is also the testing ground for a much more advanced, jet-powered surveillance drone called the Global Hawk. It circles at about 65,000 feet, making it harder to shoot down than the low-flying Predators. It can also stay aloft for 24 hours—or the equivalent of five round-trips from New York to Los Angeles—without stopping or refueling, and it can circle in one area for up to 12 hours. All the while, the plane takes infrared or radar pictures and even analyzes heat signatures, thus enabling intelligence specialists to see not only what is on the ground but also what was there. So far, Northrop has produced only four Global Hawks, but it could sell up to 60 of them by the end of the decade.

Because ofUCAVs' inherent advantages over these surveillance drones, the Air Force awarded Boeing a \$135 million contract to produce just two prototypes, the X-45s. The Y-shaped planes are 27 feet long, with a wingspan of nearly 34 feet, and should take their maiden voyages early next year. The Navy is also interested in these planes, which will be capable of flying, identifying, tracking, and hitting targets on their own. In an actual conflict, human "operators"—each monitoring four or fiveUCAVs at a time—will confirm and authorize targets.

When the planes aren't flying, they'll sit in crates with their wings removed, ready to be assembled and prepped for take-off in just one hour. If the testing goes well, Boeing could turn the development contract into a full-scale production run. Muellner says the Air Force could order more than a hundred X-45s over the next decade, with the first delivery anticipated in 2008.

That's far too soon for comfort in the view of Human Rights Watch and techno-skeptics such as Peter Neumann. But neither holds much hope of stalling theUCAV programs. Economics, and the hope of cutting casualties, are in alignment. That means robot fighters are sure to play a role in the future of war.

By Stanley Holmes in Seattle

Robots Take Wing



NAME & MAKER

DESCRIPTION

GLOBAL HAWK

GLOBAL HAWK
Northrop-Grumman

An advanced surveillance aircraft that can take radar and infrared pictures and stay aloft for more than 24 hours

PREDATOR
General Atomics

A surveillance drone that can produce high-quality video of ground action from 20,000 ft.

UCAVs
Boeing

Unmanned combat air vehicles that can carry up to 3,000 pounds of bombs and missiles

CANARD ROTOR/WING
Boeing

A pilotless high-speed attack helicopter that is still in development, it will provide reconnaissance, armed escort, and air support

tonomous aircraft is more difficult. "One challenge is writing reasonably correct software code, and one is testing the [weapons] system under all sorts of scenarios," Neumann says. "There are all kinds of false negatives and false positives" in recognizing targets.

In October, the U.S. Air Force raised the stakes in this debate. For the first time in history, it conducted remote-controlled bombing raids, penetrating deep inside Afghanistan. The agent in the attack was a Predator surveillance drone equipped with Hellfire missiles that were

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Shaking Up Merrill

Stan O'Neal is reinventing the Wall Street icon. He hardly has a choice

The low hum of cranes clearing away tons of rubble from Ground Zero reverberates through Stan O'Neal's art deco office in the north tower of New York's World Financial Center. From his 32nd-floor window, the new president of Merrill Lynch & Co. can see the south tower, where the firm occupied 19 floors until Sept. 11: Broken windows are boarded up, and debris lies all around it. But O'Neal, the first Wall Street executive to move back to the center of the financial district, has little time to ponder the disturbing view. "At the end of the day, we're about the business of conducting

Management

business," says O'Neal, who made the decision to move back. "This is where we do it."

Returning to the corporate headquarters is not just a matter of appearances or an act of bravado, the chance for a recently appointed, and relatively unknown, leader to assert himself. No, for O'Neal, it was an imperative. Almost as soon as he was named president of Merrill in July, the 50-year-old executive began an aggressive overhaul of the financial icon. It was no time to be working on the fly, without a real office, without even his senior executives nearby. (They joined their employees in



MAN OF ACTION: O'NEAL WAS QUICK TO RETURN TO LOWER MANHATTAN AFTER THE SEPTEMBER 11 ATTACKS

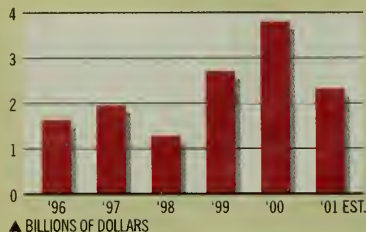




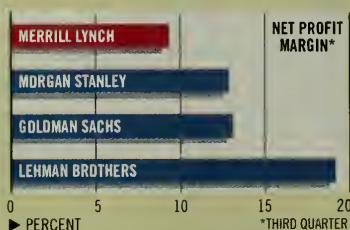
Merrill's Dilemma

The nation's biggest brokerage has been hurt by the downturn. Even worse, though, are the changes in its industry. Consolidation is rampant as investment banks team up with commercial banks in a bid to increase their capital and underwrite bigger deals. If O'Neal is unable to improve results, Merrill could find its days as an independent company numbered.

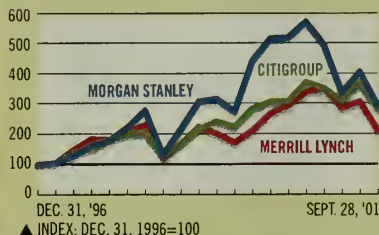
NET EARNINGS HAVE BEEN WALLOPED...



...AND PROFIT MARGINS TRAIL RIVALS'...



...HURTING THE STOCK PRICE



Data: Salomon Smith Barney, Bloomberg Financial Markets, company reports

MEANWHILE, COMPETITORS ARE PAIRING UP

- ▶ Chase and J.P. Morgan merge as **J.P. MORGAN CHASE**, announced September, 2000
- ▶ UBS and PaineWebber merge as **UBS PAINEWEBBER**, announced July, 2000
- ▶ Credit Suisse First Boston and DLJ merge as **CSFB**, announced August, 2000



sites scattered from midtown Manhattan to Princeton, N.J.)

Even though he's a 15-year veteran of the company, O'Neal was unknown to many inside Merrill before his appointment, which made him heir apparent to Chief Executive David H. Komansky. Now they're finding out what execs who have worked closely with him already know: Stan O'Neal may keep a low profile, but he is a force to be reckoned with. One of his first acts as president was to drive off two of his three chief rivals for the job, one of whom was the son of a founder. Even Komansky seems a diminished presence since O'Neal's appointment. Many believe the board of directors has lost faith in Komansky. And for all practical purposes, O'Neal is running Merrill. In fact, he has been almost since July.

Management

O'Neal, who stands to be the first African American to run a major investment bank and one of the only Merrill chiefs never to work as a broker, faces formidable challenges. Merrill embodies the problems of businesses that grow to excess, that come to prize bulk before profitability. It's America's biggest brokerage and one of the nation's top three investment banks. Perhaps no other firm had been so associated with the bull market, with clients ranging from retired shopkeepers to multibillion-dollar pension funds. In less than a decade, it made 19 acquisitions, paying top dollar for several.

It also spent generously, some would say extravagantly, on employees and clients. Low-level managers traveled in chauffeured cars to appointments, and investment bankers en-

joyed concierge services on Merrill's tab. The firm advised wealthy clients on everything from how to help their kids cope with money to how to purchase a private jet. Some perks may have been wasteful, but in the heady days of the bull market, no one particularly cared.

But then the go-go '90s ended, and Merrill's fortunes quickly changed. Today, both its profit margins and return on equity trail those of rivals. That's bad news for any company, but for one of the last remaining independent firms on Wall Street, it's especially worrisome. Corporate clients around the globe are demanding capital-intensive services, and increasingly commercial-banking powerhouses are happy to provide them—at cut-rate prices. That's forcing investment banks to offer their services at a discount while also raising their capital requirements. And it has led to a spate of mergers that are forcing investment banks into the arms of megabanks, such as J.P. Morgan and Chase or UBS and PaineWebber.

DIFFICULT TIME. O'Neal's choice is clear: He can either boost performance and be an acquirer or risk watching Merrill be swallowed by a better-run rival. The firm's stock price has already fallen 31.7% this year. By comparison, Citigroup's shares have slipped only 9% and J.P. Morgan Chase's are down 18%. In an Oct. 17 report, Salomon Smith Barney financial-services analyst Guy Moszkowski predicted that if O'Neal can't bring Merrill's profit margins in line with the pack, the board of directors may push O'Neal to sell, perhaps as early as 18 months from now. O'Neal says that kind of talk is "crap." The board declined to comment.

Making the situation even more risky, O'Neal is attempting

2001 Estimates at a Glance

TOTAL NET REVENUES \$22 billion, down 19% from previous year

TOTAL NET EARNINGS \$2.3 billion, down 39% from previous year

CORPORATE AND INSTITUTIONAL CLIENT SERVICES

57.1% of net earnings

NET REVENUES \$10 billion

NET EARNINGS \$1.3 billion

Assists companies in debt and equity issuances and trades and provides strategic merger and acquisition advice. Trades for Merrill's own account. Like its peers, Merrill is suffering from weak markets and a dismal investment-banking environment.

PRIVATE CLIENT SERVICES

32.2% of net earnings

NET REVENUES \$10 billion

NET EARNINGS \$740 million

As the largest broker in the U.S., Merrill Lynch markets financial advice, stocks, and bonds through a sales force of 15,000 brokers. But the firm's rapid global expansion has cost the company: Its international client group suffered a \$51 million loss in the first nine months of 2001, vs. a \$155 million pretax profit a year earlier.

ASSET-MANAGEMENT SERVICES

10.7% of net earnings

NET REVENUES \$2 billion

NET EARNINGS \$250 million

Manages investments for individuals and corporations. Market depreciation and foreign exchange fluctuations reduced assets under management by 5%, to \$507 billion, in the third quarter.

Data: Morgan Stanley Dean Witter & Co., company reports

to bring Merrill into line during a time of great economic and political uncertainty. Trading is slow, mergers and acquisitions are few, and initial public offerings are on hold. Merrill is expected to earn only \$2 billion on net revenues of \$22 billion this year, 39% less than in 2000. Further complicating matters is the fact that he will be redirecting businesses while many of his senior staff are just settling in to new jobs: By the end of the year, only five of the 24 members of his executive management team will be in their same positions.

O'Neal is unsparing in his assessment of Merrill's problems and unsentimental about change at the 87-year-old firm. Indeed, his overhaul of Merrill Lynch will involve nothing less than abandoning the company's mission to be all things to all clients around the globe. O'Neal is determined to double up resources in areas that are high-profit and chop unflinchingly where making money is harder. "That means being properly positioned in the markets we want to be positioned in," says

O'Neal. "It also means not expending resources on those things that will not ultimately produce the growth and profits we want to achieve."

That's a watershed for Merrill. Its brokers, who once brought Wall Street to Main Street, are now focused squarely on courting the rich, those with \$1 million or more to invest. Merrill's investment bankers will concentrate on select industries where their relationships are strongest: financial services, power and energy, telecom, and technology. Overseas, it will mean retreating from mass retail ventures in Japan and Europe to focus on high-margin wealthy clients. All this with fewer people: O'Neal plans to lay off some 10,000 employees, or one of every six.

CULTURE SHOCK. O'Neal's plans to transform the Merrill culture are just as ambitious. He says the new Merrill will be a meritocracy where talent, not seniority, rises to the top. He intends to put an end to the firm's benevolent "Mother Merrill" culture and its civil-service mind-set. "I don't like the term. I've never used it," he says. "I don't think it's realistic in a 70,000-person organization spread out around the world."

The kind of change O'Neal envisions is always disruptive. Similar undertakings have brought others, like Jacques A. Nasser at Ford Motor Co. and Durk I. Jager at Procter & Gamble Co., to grief. For some, O'Neal's pace is too quick, his timing is off. (Shouldn't he have paused longer after September 11, they ask.) Already, the three other executives who ran Merrill's key businesses have been replaced. With this much turmoil, other executives are sure to depart. "Any time you make this many changes in a down market, it raises the risk premium associated with the company," says Henry McVey, securities industry analyst at Morgan Stanley.

Merrill simply can't afford to behave as if it were still 1999. Today, the company devotes fully 54¢ of every dollar it takes in to employee compensation, compared with an estimated 49¢ at Goldman, Sachs & Co. and 52¢ at Morgan Stanley Dean Witter & Co. To keep up with those ri-

O'Neal's Mandate



BUILD PROFITS

Boost Merrill Lynch's flagging profit margins and its stock price substantially over the next 18 months in order to satisfy the board and to keep the firm safe from predators

NARROW FOCUS

Move Merrill from financial supermarket to more specialized firm serving clients with more than \$100,000 in assets, offering strategic advice to corporations, and selling higher-fee mutual funds

CUT COSTS

May lay off as many as 10,000 of the firm's 62,800 employees worldwide and terminate some overseas operations



Never a broker himself, O'Neal won the respect of many by shifting the focus to wealthier clients

vals, Merrill also has to boost its return on equity and profit margins. Merrill earned only a 9% return on its equity in the third quarter. Morgan Stanley got 15%, Goldman 10%. And Merrill posted a relatively weak 13% operating profit margin, while Goldman Sachs recorded 21% and Morgan Stanley 17%. O'Neal has vowed to build margins to 24% by 2003.

To get there, he has ordered his managers to reduce their expenses to 1998 levels. "I think O'Neal is conscious of the things we look at in the investment community as far as expense control and meeting earnings targets, and he's pretty serious about it," says James K. Schmidt, manager of John Hancock Financial Industries Fund, which had about 6% of its \$535 million in Merrill shares as of Sept. 30.

O'Neal's dress rehearsal for his current job came last year, when he ran Merrill's brokerage operations. Merrill had plenty of accounts, but most were under \$100,000—an increasingly unprofitable niche. O'Neal's solution: He cut the payroll by 13% and slashed the level of personal service for those small accounts. Then he focused on bringing in high-end private banking with \$1 million or more in assets.

Management

CALM AND COLLECTED. The strategy worked. While some of those ordinary clients fled, most stayed—and Merrill says it doubled the amount of revenue per dollar of assets in their accounts and reduced operating costs by \$800 million. And after an initial outcry from brokers worried about their future and resentful of a boss who didn't come up through the ranks, O'Neal won some respect. "There were many in the organization who said, 'How can anyone who has not sat in our chairs have the wisdom and the experience and the skills to lead the organization?'" says Augie Cennane, a broker in Columbus, Ohio. "Stan has proved those people wrong."

Success always makes people more popular. But even so, O'Neal is still more respected than liked. And he's no Komansky, who describes himself as "a back-slapping, gregarious person." O'Neal is cerebral, reserved, and supremely calm. Af-

ter fleeing the World Financial Center on Sept. 11 with the 9,000 employees in the building at the time, O'Neal set up at Merrill's "command center" 15 blocks away. He let nothing escape his attention, from the firm's open trading positions to securing desks for everybody. He kept his sense of humor, too. At one point, O'Neal turned to a group and said: "Remind me again why I wanted this job?" But when it came time to move back to headquarters, O'Neal didn't get around to letting everyone know. Many employees heard the news when he announced it on television.

Some employees describe O'Neal as an "enigma." He gives little away and admits that he shuts down in meetings when he believes someone is just telling him what he wants to hear. However, "there are other times when it's clear exactly what I think of a subject," he says. O'Neal's closest confidantes are James P. Gorman, who joined Merrill from consultant McKInsey & Co. and is now head of the U.S. brokerage operation, and Thomas H. Patrick, chief financial officer and the most likely candidate for chief operating officer.

To hear Komansky tell it, their partnership is clicking. "You don't want to slink out the back door thinking you left the place a mess," he says. "My most important function is to provide the kind of guidance that will put Stan in the position to be the best CEO that Merrill Lynch has ever had." But some insiders believe Merrill's board could ask Komansky, who became CEO in 1996, to retire as early as next year instead of in 2004, when he turns 65. They also say the board forced Komansky to select a successor earlier than he planned.

Merrill Lynch: A History

1914 Charles E. Merrill founds Charles E. Merrill & Co. at 7 Wall Street in New York City. The firm helps growing companies raise capital.



LYNCH IN THE '20S

1915 Edmund C. Lynch joins the company, which becomes Merrill Lynch & Co.

1941 First Wall Street firm to issue an annual report.

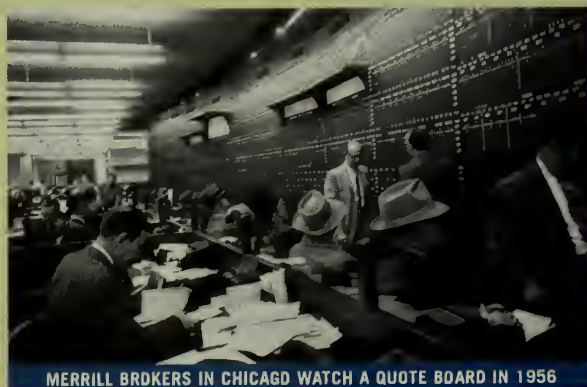


MERRILL IN 1947

1959 Joins the New York Stock Exchange.

1960 London office opens.

1971 Goes public on June 23, offering 4 million



MERRILL BROKERS IN CHICAGO WATCH A QUOTE BOARD IN 1956

shares at a split-adjusted price of \$1.75 per share. Launches its "bullish on America" ad campaign.

1977 Introduces the Cash Management Account, a product that for the first time combines brokerage and banking services, including a securities margin

account, money market and checking accounts, and a Visa debit card.

1986 First non-Japanese securities firm to become a regular member of the Tokyo Stock Exchange.

1996 David H. Komansky becomes CEO.

1997 Total retail assets reach \$1 trillion.



A LONDON TRADER IN 1998

1998 In response to the Asian financial crisis, Merrill lays off 5% of its workforce.

2000 Chief Financial Officer Stanley O'Neal is named head of the firm's army of retail stockbrokers.

JULY 2001 Board of directors appoints O'Neal president and chief operating officer.

Data: Merrill Lynch & Co., *BusinessWeek*

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DAVID KOMANSKY

"A change of style, a change of points of view, is critical," says the CEO, who some insiders say may be asked to retire early

feared GM would become a victim of its own success bogged down by high costs, low quality, and massive overcapacity. "I was concerned I would wake up 10 years hence and be very successful in a context I was not entirely happy with," he says. In August, O'Neal became a member of GM's board.

O'Neal hadn't been at Merrill for more than three years when he was made head of the firm's high-yield bond business. After Michael R. Milken's Drexel Burnham Lambert Inc. blew up in 1990, O'Neal led a group of young vice-presidents on a sales drive to win over new clients. The group debated high-yield bond structures while shooting baskets in O'Neal's office. (The hoop has since been replaced by elegant Shona sculptures from Zimbabwe.) The effort paid off: Merrill climbed to No. 1 and remained either first or second in junk bonds until O'Neal was promoted to lead the entire capital-markets businesses in 1995. After he left, Merrill slid steadily to No. 8. "I never took Stan on a pitch where we didn't win the business," recalls Bennett Rosenthal, now a partner at Ares Management in Los Angeles, an affiliate of Apollo Advisors. "He was obsessed with being No. 1."

to and overruled his first choice, Jeffrey M. Peek. Komansky denies it: "I see the next 10 years as being very different from the past. A change of style, a change of points of view, is critical." Board members declined to comment.

O'Neal certainly sees the world through different eyes than many at Merrill. For starters, he was raised on a subsistence farm in Alabama, and then in a housing project in Atlanta. In Alabama, he walked a mile to school, a shack with a potbelly stove. In Atlanta, his father, who worked on an assembly line for General

What most distinguishes O'Neal from his colleagues though, is his calm. He's stern, but few have seen him shout at his staff or throw a tantrum. "The more pressured the situation, the cooler he gets," says Raymond McGuire, an investment banker at Morgan Stanley who used to work with O'Neal. When hedge fund Long-Term Capital Management collapsed in 1998, O'Neal, then Merrill's chief financial officer, steered the firm through a severe liquidity crunch without hesitation. Afterward, O'Neal put a funding program in place to ensure that Merrill would never be caught off guard again. Consequently, when markets fell after the September 11 attacks, the firm had plenty of access to cash.

Still, well into his career at Merrill, O'Neal was relatively

Management

al Motors Corp., struggled to feed his wife and four children on less than \$50 a week. It was he who encouraged Stan to attend college. O'Neal alternated six-week stints in the factory in Doraville, Ga., with six weeks at a GM-sponsored college in Detroit until he got his degree. From there, he went on to Harvard Business School, rose to assistant treasurer at GM, and became an investment banker at Merrill at age 35.

WORKAHOLIC. In the '70s, GM was full of driven would-be executives, but even so, O'Neal stood out. He moved from entry-level analyst to director level in the treasurer's office in three years. "That's about as fast as you can do it," says John D. Finnegan, chairman of General Motors Acceptance Corp. and a former colleague. A workaholic from the start, O'Neal often remained in the office until 10 p.m. "He worked hard to take himself to the next level," recalls Louis R. Hughes, former president of GM International Operations, who hired O'Neal. "He had a very large Afro American haircut. He got conservative very quickly." He lost his Southern drawl fast, too. But "he was proud of the fact that he had started at the bottom," says Sandy Robertson, founder of investment bank Robertson Stephens, who dealt with O'Neal during his GM days.

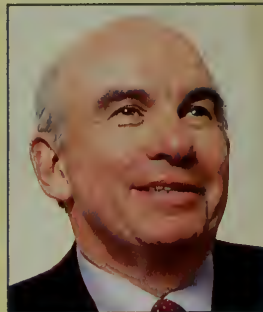
He could size up an opportunity quickly as well. When O'Neal sensed the balance of power shifting away from the finance staff at GM, he followed his mentor, former Treasurer Courtney F. Jones, to Merrill. There he joined the ranks of investment bankers he knew from working on acquisitions of Electronic Data Systems Corp. and Hughes Electronics Corp. There was another reason O'Neal was ready to move on: He

O'Neal's Confidantes



JAMES GORMAN

Now head of the U.S. brokerage operation, he joined Merrill from consultant McKinsey & Co.



TOM PATRICK

The firm's chief financial officer is considered the most likely candidate for chief operating officer

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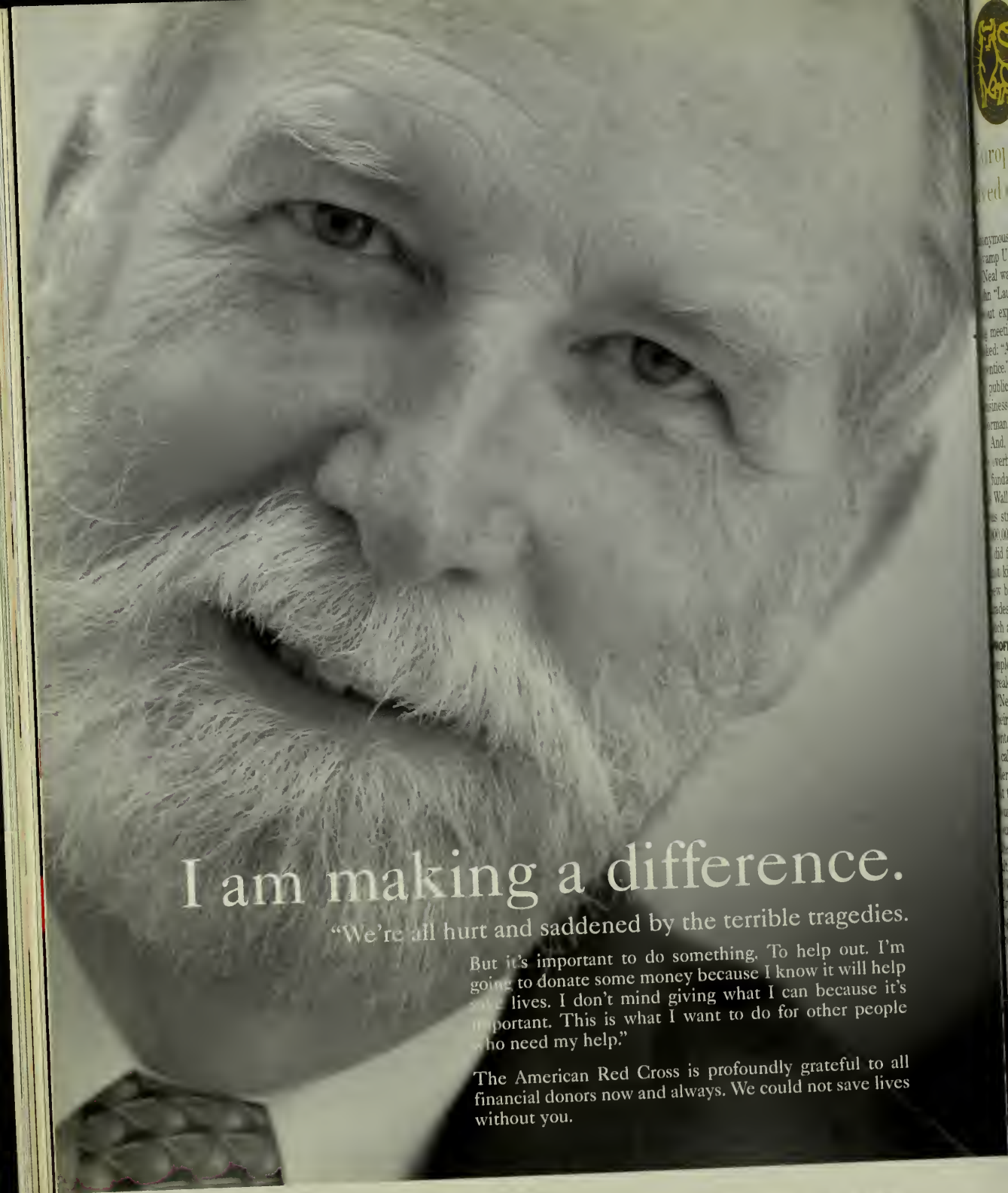
We encourage you to call with any tax question.
We'll cut through the red tape and answer quickly.

You can also get information on the IRS Website at

www.irs.gov



THE INTERNAL REVENUE SERVICE • WORKING TO PUT SERVICE FIRST



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"We're all hurt and saddened by the terrible tragedies.

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O'Neal's first task is finessing a retreat from initiatives in Europe and Japan that never lived up to their promise

onymous. That changed when Komansky brought him in to revamp U.S. retail brokerage operations in February, 2000. O'Neal was an unwelcome replacement for popular veteran John "Launny" Steffens, and Merrill's brokers were not shy about expressing their contempt. In one of O'Neal's first big meetings, he was sitting next to Steffens when a broker asked: "And who are you?" O'Neal answered: "Launny's apprentice." That broker wasn't alone in giving him a hard time in public settings. "They would ask, 'How can you lead our business when you have never even sold a stock?'" recalls Gorman, who worked with O'Neal at the brokerage.

And, of course, O'Neal set off a real furor when he began to overhaul operations there. O'Neal believed he had inherited a fundamentally flawed business. Expenses were spiraling as Wall Street firms fought over top brokers. Worse, Merrill was struggling to deliver the same service to clients with \$100,000 to invest, who make up 67% of Merrill's accounts, as it did for multimillionaires. But the reality was that providing that kind of service to small fry cost too much. Meanwhile, a new breed of individual investor who was looking for cheap trades, not advice, was increasingly turning to discounters such as Charles Schwab & Co.

PROFIT FIRST. Just months into the job, O'Neal laid off 2,000 employees and changed the lineup of executives to help him break down the walls between sales, marketing, and products. O'Neal segmented the business so that the rich get to talk to their own brokers and everyone else deals with a general call center. That way, small-time clients were guaranteed to receive a call from a Merrill representative at least once a quarter, yet Merrill didn't have to pay high-priced brokers to make them. At the other end of the spectrum, he devoted considerable resources to winning clients with at least \$1 million to invest. Of course, there's not a competitor around that's not going after the same market. But Merrill estimates that the numbers of ultra-rich, now 7.2 million strong worldwide, will grow by 3% annually over the next five years. And there's no one firm that dominates. Like other businesses, the U.S. brokerage is being tested: In the third quarter, both earnings and revenues were down compared to a year ago.

As president and CEO-designate, O'Neal will have to draw on all of his resources. His first challenge will be finessing Merrill's retreat from recent initiatives in Europe and Japan that never lived up to their promise. The firm had hoped to expand its reach down to small investors. In April, 2000, Merrill and HSBC announced a joint venture to offer online investment advice to retail investors worldwide. The arrangement was generally viewed as a prelude to a possible merger between the two. But it never amounted to much, and O'Neal may ditch it.

When Merrill bought Japan's fourth-largest brokerage, Yamaichi Securities, after Yamaichi went bankrupt in 1998, the firm figured it could easily win over the average "salaryman" who kept his money in savings accounts. It hasn't happened. O'Neal plans to pull back, even though "the Japanese business is on track to break even in 2002," says Winthrop H. Smith Jr., who used to run the international brokerage business and was a contender for O'Neal's job. He announced his retirement in early October after O'Neal removed him from

his position. Retail operations in Japan and Europe have accounted for a \$180 million loss for Merrill annually. "Spending more money on a flawed business model will not correct the fundamental problem," says O'Neal.

What he hopes to spend money on is expanding banking services for foreign clients with at least \$1 million to invest. Sound familiar? G. Kelly Martin, the new president of international private-client services, believes operating margins of at least 15% are possible even in the downturn. In the third quarter, the business posted a \$40 million pretax loss.

O'Neal wants to apply the same profit-first principle to Merrill's asset-management business. Before, Merrill's aim was to offer a wider choice of funds than its competitors, at whatever the cost and whatever the profit margin. Now, Merrill Lynch Investment Managers wants to boost its profit margins from the teens to around 30% by selling more of its higher-fee mutual funds. "Five years ago, an asset in the door was a reasonable goal because every asset was profitable," says Robert C. Doll, who became head of Merrill Lynch Investment Managers after Peek resigned in October. O'Neal also hopes Merrill brokers will sell more of the company's own mutual funds, though that may be difficult since as

Stanley O'Neal

BORN Oct. 7, 1951, Roanoke, Ala. Grew up in nearby Wedowee, where his parents still live. His mother gave birth in neighboring town because hospitals in Wedowee refused to treat African Americans.

EDUCATION BS, industrial administration, Kettering Institute, 1974; MBA, Harvard University, 1978.

POSITION President, Merrill Lynch, since July.

FIRST JOB Worked part-time on a General Motors assembly line in Doraville, Ga., while attending Kettering, a GM-run college.

CAREER TRACK Joined GM's Treasury Office in 1978. Went to Merrill as an investment banker in 1986. Promoted to CFO in 1998.

WHY HE JOINED MERRILL LYNCH "I thought investment bankers were smart. But I didn't think they were five times smarter than me, which is about what they were making."

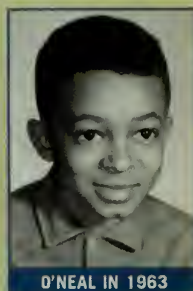
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AFTER HOURS Board member of Ronald McDonald House since 1998 and GM since August, 2001.

WAY AFTER HOURS Impersonates famous people and colleagues—to their faces. "You need to be very serious about your purpose and what it is you're doing, but if you can't find things to laugh at and people to laugh with, it would strike me as a terrible existence."

THE LAST THING HE NEEDS "I don't want people trying to figure out what I think. If someone says something just because they think I want to hear it, I'll shut down."

FAMILY Married to Nancy Garvey, an economist who worked with him in GM's treasury office. She now cares for their 10-year-old twins, a son and a daughter.



a group they offer very average returns. Now, about 30% of brokers' sales are Merrill funds. O'Neal would like to see that share grow to 50%.

As for the investment bank, O'Neal is convinced Merrill can expand its highly profitable equity-trading capabilities. He also wants Merrill to be as

Management

much of a player in interest-rate, derivative, and foreign exchange trading as it is in debt and equity issuance. "We have the greatest cash equity franchise in the world," he says. "Why can't we have the greatest equity derivative franchise? We should. We can. We will."

O'Neal may talk tough, but he is leading Merrill through an unprecedented transformation during a time of intense uncertainty in markets and economies around the world. He may be as calm as ever. But his employees are on edge and he and his executives are on notice. If he can't fix Merrill, someone from the outside may get the chance.

By Emily Thornton in New York, with Anne Tergesen in New York, David Welch in Detroit, and bureau reports

BusinessWeek online

For an interview with CEO David Komansky, go to the Nov. 12 issue online at www.businessweek.com.

How Merrill Lost Its Way in Japan

Wall Street powerhouses have long had designs on Japan's fabled \$10 trillion-plus in household savings. None more so than Merrill Lynch & Co., which in 1998 snapped up Japan's fourth-biggest broker, the failed Yamaichi Securities Co. It was billed as a breakthrough foreign takeover that

major ad campaign said it all: "Merrill Lynch—Somebody You Can Talk To."

Once it won their confidence, Merrill would have access to a deep pool of Japanese investors that would help the firm sell off big chunks of initial public offerings underwritten by its investment-banking arm. In other words, the retail strategy was

would soon see the emergence of a broad-based investing culture similar to that of Europe, if not the U.S. Yet individual investors in Japan still account for only 6% of the stock market. Thanks to economic uncertainty and a decade-long bear market, some 70% of household savings are parked in bank accounts or Japan's state-run postal savings system.

WARM AND FUZZY. Not even existing Yamaichi clients were impressed by Merrill's Wall Street pedigree. Instead, they recalled that a mismanaged Yamaichi misled clients about its financial health for months and went belly-up in late 1997. No amount of warm, fuzzy marketing could change that perception.

It also didn't help that Merrill bore the costs of retraining some 2,000 ex-Yamaichi employees to balance their obsession with transaction volumes—and commissions—with quaint ideas like trying to invest a client's money wisely. A Merrill spokesperson in Japan—top executives declined to talk—

says the broker still expects to break even at the end of 2002.

True, there is a niche of wealthy and sophisticated Japanese investors, but not enough to justify the brick-and-mortar investment that Merrill took on. Fidelity Investments distributes its funds via banks and brokers. Citibank peddles its financial wares through its existing retail bank network and online. Meanwhile, with Merrill's imminent retreat, Japan's trillions in uninvested cash remain a tantalizing prize for the next Wall Street titan ready to try its luck.

By Brian Brenner in Tokyo



MERRILL'S FABLED IMAGE ON WALL STREET HASN'T CUT IT IN TOKYO

would pull Japanese finance out of the dark ages. The goal, Merrill Japan Chairman Hisashi Moriya intoned at the time, was to become "Japan's most trusted broker."

The idea was that Merrill's pedigree would wow Japanese investors. After all, local houses like Yamaichi and Nomura Securities Co. churned and burned accounts, levied larcenous commissions, and generally treated investors badly. Merrill, via a reformed Yamaichi, would fix all that with U.S.-style compliance training, a global menu of mutual funds, and sage financial planning. Its first ma-

key to stoking Merrill's more lucrative business underwriting stocks and bonds and offering financial advice and strategies for its blue-chip corporate clients in Japan.

Instead, the venture, Merrill Lynch Japan Securities, turned into a money pit. Although it attracted a respectable \$14 billion in assets, the retail unit has also devoured estimated startup costs of \$200 million, plus cumulative losses of at least twice that over three years. Now much of the venture is likely to be shut down.

What went wrong? Plenty. Merrill essentially made a bet that Japan

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CHAIRMAN
LAY IS NOW
CEO, TOO

ACCOUNTING

THE ENRON DEBACLE

Byzantine deals have shattered the energy outfit's credibility

Executives at high-flying Enron Corp. never seemed overly concerned with how the rest of the world viewed their business practices. Earlier this year, the California Attorney General had to get a court order to collect documents in an industrywide investigation into energy price fixing. And when an analyst challenged former CEO Jeffrey K. Skilling in a conference call to produce Enron's balance sheet, Skilling called him an "ass—." Still, even some Enron executives

worried that the company had gone too far with two complex partnerships set up in 1999 to buy company assets and hedge investments. With Enron's then-chief financial officer acting as general manager of the partnerships and in a position to personally benefit from their investments, the potential for a conflict of interest and backlash from investors seemed overwhelming. "Internally, everybody said this is not a good idea," says a source close to the company.

But no one could have predicted such a jaw-dropping outcome for the nation's largest and most innovative energy trader. Since Oct. 16, when Enron revealed a \$35 million charge to earnings to reflect losses on those partnerships and was forced to knock \$1.2 billion off its shareholders' equity, the company's stock has plunged 60%. The Securities & Exchange Commission is investigating Enron's accounting for its partnerships and whether it properly

disclosed them to investors (page 110).

Suddenly the company, which brought high-tech and complex finance to energy trading, is essentially trying to avoid run on the bank. Moody's Investors Service has already downgraded the company's debt. Enron says it is meeting with credit agencies to calm their fears and analysts say Enron is working on a turnaround plan that would likely include accelerating asset sales, issuing shares and obtaining new credit lines. Enron's board has set up a special committee to look into its controversial partnerships. But analysts also worry that Enron's trading partners could pull the plug if they lose confidence that it can honor its trades.

"ON CRACK?" Inside Enron, once-cocky employees are reeling. They were still puzzling over the abrupt Aug. 14 departure of CEO Skilling when the company announced on Oct. 24 that CFO Andrew S. Fastow, architect of the controversial

HOW ONE OF THE ENRON PARTNERSHIPS WORKED

Enron's partnerships are a thicket of complexity. A 30-year-old Whitewing Associates, for instance, involves at least nine different legal entities. But Enron's role in most of these deals is actually simple: Enron makes the investments in foreign and domestic projects, prepares the balance sheet and gets them ready for sale. Enron's role serves as an example of how Enron structures its deals and the risks it runs:

THE PLAYERS

Investment funds and insurers buy \$1.5 billion in short-term notes issued by an entity called the Osprey Trust, and put the money in Whitewing. In return, they receive an annual interest of 8.31% and are due to get their money back on Jan. 15, 2003. Enron contributed \$1.7 billion in stock and notes and sold Whitewing \$807 million of investments, including some in Turkey.

THE INVESTMENTS

Whitewing put \$3.2 billion of capital, Enron put \$115 million into Enron debt and bought stakes in the Enron investments. It also has \$2 billion of Enron convertible notes and notes.

THE RISKS

Investments can't be sold for enough to repay the notes, Enron would have to issue enough new notes to make up the shortfall. Or if ratings on Enron debt fall to junk status and the company's price stays depressed, a quarter of the note holders could try to force similar action.

Private LJM investments—which got their name from the first initials of his wife and children—was removed from his post and on leave. In a tense meeting held at a Houston hotel after the latest financial disclosures, soft-spoken Chairman and CEO Kenneth L. Lay faced 1,600 employees, with another 5,000 hooked up to the Web. One irate worker asked if Lay was "on crack." Lay, an economist by training, turned over day-to-day management in 1997. Until Skilling quit, citing personal reasons unrelated to Enron, Lay was talking about retirement, sources say. Now he is facing his biggest challenge ever: "Ken is looking at a 30-year career of accomplishment going down in flames. This is just awful," says one source.

On the surface, at least, Enron's off-balance-sheet maneuvering hardly seems like the stuff that would crater a company. Amazingly, sources close to Enron claim that one rationale for Fastow's deals was

to save an estimated \$30 million a year in investment-banking fees. Fastow's involvement in the partnerships, which bought assets from Enron, including stakes in telecom and energy, was supposed to make the deals simpler for the investment bankers and thus cheaper. They were also meant, according to sources close to the company, to hedge Enron's investments in potentially risky assets while allowing it to maintain some control over them. Enron says Fastow made money for himself on some of the deals, but insiders insist there were less controversial ways to enrich him if that were the aim. Fastow did not return calls seeking comment. Lay, who de-



clined to comment for this story, has said that the partnerships were properly vetted by Enron's attorneys and internal and external auditors and were approved by its board. A source familiar with Enron agrees: "We had the best lawyers in the world saying, 'It looks fine.'"

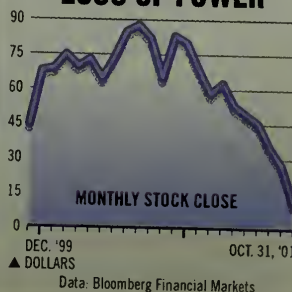
But whatever Enron's reasons for creating the LJM partnerships, the problems were compounded by scanty disclosure. The deals were first revealed in a 1999 proxy, raising concerns from investors and analysts. By this summer, when Enron's stock was falling and its bets in broadband were souring, complaints about LJM grew louder. So in June, Fastow pulled out of the partnerships. When the write-offs came, Enron enraged analysts and investors further by failing to disclose the hit to equity in its third-quarter earnings press release. Instead, Lay mentioned it in a conference call with analysts. "We found it disconcerting that the company waited to disclose the additional \$1.2 billion charge to equity in a fleeting comment in the middle of its conference call," says UBS Warburg analyst Ronald Barone.

BAD BETS. Still, Enron's credibility did not vanish overnight. Analysts have been lobbying for years for more information about how and where Enron makes its money in its often byzantine trading business. While the company's revenues were soaring from \$9.2 billion in 1995 to \$100.8 billion in 2000 and its stock was returning 500% during the same six-year period, Enron's aggressive, even arrogant managers could ignore Wall Street's complaints with impunity. But after its stock price collapsed this year (chart), the company's attitude and operational missteps quickly caught up. And there was plenty to worry about. The company's \$3 billion power plant in India wasn't paying its bills amid a political controversy; its highly ballyhooed business for trading high-speed communications capacity was crippled by the telecom industry meltdown; and its calamitous foray into the

water business with Azurix Corp. has already cost Enron at least \$574 million in write-offs.

These bad bets and the expensive LJM shock have investors worried about what else might be lurking at Enron. Many aren't sticking around to find out. "I think the lack of disclosure on their financial engineering killed the credibility of

ENRON'S SUDDEN LOSS OF POWER





IN HAPPIER DAYS

Enron's red-hot performance put former CEO Skilling on BW's Feb. 12 cover



the management team," says Richard A. Giesen, who manages the Munder Power Plus fund, which dumped its Enron shares about a month ago.

It's not clear just how many off-balance-sheet financing vehicles Enron has used over time. Some were created years ago to finance oil and gas producers. Analysts and sources close to the deals say there's no particular risk in these to Enron shareholders. Other interconnected entities, such as White-wing, Osprey, Atlantic Water Trust, and Marlin Water Trust, were a way to get assets no longer central to Enron's strategy off its balance sheet, freeing capital and credit for the core energy

business and ventures like broadband (table, page 107).

To entice institutional investors such as pension funds and insurers into these deals, Enron promised to kick in equity if asset sales weren't enough to cover debt. Such "mandatory equity" deals have been used by at least a half-dozen others in the energy and telecom industries, including El Paso, Williams, and Dominion, says Standard & Poor's director Todd A. Shipman. "Nobody's going to find anything that's particularly unique or below board" in such deals, says one in-

vestment banker specializing in the energy business.

Worst case, which Shipman considers unlikely, Enron could be on the hook for about \$3 billion in its mandatory-equity deals. That could mean diluting its shares by more than 25% at today's prices. Analyst John E. Olson at Sanders Morris Harris Inc. figures a 9% dilution is more likely. Even if this \$3 billion in debt were included on Enron's balance sheet now, the debt-to-capital ratio would climb to 54% from about 49% at the end of June. Such a change would pressure Enron's credit rating but not push it below investment grade, says Shipman.

HUGE HIT. Fastow's LJM, a private equity fund, was a different kind of animal, according to sources familiar with the arrangements. It bought energy and other assets from Enron, which booked gains and losses on those deals. LJM was also involved in complex hedging that was supposed to reduce the volatility of some of Enron's investments, including stakes in high-tech and telecom businesses and an interest in New Power Co., which markets power to consumers. When Enron terminated these deals in September, it took the \$1.2 billion hit to equity.

But the more immediate question is whether trading partners will stick with the company. The first place that might show up is in Enron's highly successful online platform



HIGH RISK

Enron is the only nonbank in the credit default swap market

DERIVATIVES DANGER?

Lately, owners of Enron's equity, bonds, and loans have been struggling to understand how exposed the company is to risks of losses that they didn't know about before. Now, as a fuller picture of Enron's entanglements with partnerships begins to emerge, investors have something else to worry about: credit default swaps, known as CDSS for short.

That's financial marketspeak for insurance on bonds and bank loans. Their owners pay a premium for coverage that reimburses them for any losses they have if their investments go bad. The CDS market has existed only for about two years, but it's growing fast. Goldman,

Sachs & Co. and others estimate that bonds and loans with a face value of between \$1 trillion and \$1.5 trillion are covered. Not surprisingly, big banks with hefty balance sheets such as J. P. Morgan Chase, Merrill Lynch, and Deutsche Bank dominate the market.

Enron, however, is a player—and the only significant one that isn't also a bank. Competitors say that although Enron has issued only between \$500 million and \$700 million worth of CDSS so far this year, it had ambitious plans to offer them online. "They don't belong in this market," says one trader. "They don't understand the implications." Enron did not return calls seeking comment.

Of course, neither Enron nor oth-

ers will have to pay out unless the loans and bonds they're insuring turn bad. Trouble is, this year is potentially a doozy for losses on corporate debt. Corporate defaults could reach a record of \$100 billion, says Standard & Poor's, like *BusinessWeek* a unit of The McGraw-Hill Companies. Regulators say shaky bank loans hit a record \$193 billion by early October.

If Enron has insured any of the bad debt, it might have to take charges for losses if they exceed the premiums it has been getting. With all that has been happening in recent weeks, that's the last thing it needs.

By Heather Timmons
in New York

A woman with long dark hair, wearing a yellow cardigan over a white t-shirt, is smiling and holding a piggy bank. She is in a brightly lit shopping mall with other people in the background. The scene is slightly blurred, suggesting movement.

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which trades everything from gas and electricity to weather derivatives. To reassure its partners, Enron is scrambling to shore up its liquidity. It has already tapped \$3 billion in credit lines and is trying to arrange another \$1 billion. Shipman says he has seen no signs of massive customer defections or drastically worsened credit terms. Still, rival traders are wary. "We certainly have taken a closer look at Enron in the last week to 10 days and will continue to manage the credit risk, but we're still doing business with the company as usual," says Keith G. Stamm, CEO of power and gas trader Aquila Inc.

"SPEEDING TRAIN." Still, with the stock battered and rating agencies considering further downgrades, that could rapidly change. In recent days, the uncertainty about Enron's future has reduced investors' appetite for Enron debt. "No one wants to speculate on the direction or their likelihood of survival," says a credit-derivatives salesperson. "It's really difficult to get in front of a speeding train."

Even if Lay can calm his trading partners, he and his management team face a much tougher task of restoring their credibility on Wall Street. With the stock now hovering around \$14—down from a high of \$90 in August, 2000—some even believe that Enron could be a takeover target for the likes of GE Capital or Royal Dutch/Shell Group. Both declined to comment. Would Enron sell? One source close to the company says Enron has talked about possible mergers and strategic alliances in the past with Royal Dutch/Shell, among others. "If they're really worried about liquidity, they might take the easy way out," he says.

If Enron does pull through this crisis, some suspect it will be a humbler, more risk-averse place. The company that once believed it could expand its trading and logistics empire to all manner of commodities—from advertising space to steel—will be forced to scale back its grandiose visions. That's something some investors applaud. "The company should focus on its strengths," says William N. Adams, senior energy analyst at Banc of America Capital Management, a major shareholder. But that's a far less exciting place than Enron's energy cowboys ever hoped to roam.

By Stephanie Anderson Forest and Wendy Zellner in Dallas, with Heather Timmons in New York

COMMENTARY

By Mike McNamee

ENRON'S CLOUT WON'T SWAY THE SEC

For Securities & Exchange Commission Chairman Harvey L.

Pitt, the SEC's investigation into Enron Corp. could hardly have come at a worse time. The future of Pitt's ambitious agenda of reforms in securities regulation could depend on how well he handles this case.

Enron's political clout and close ties

where most cases are settled by negotiated penalties, not court-imposed fines—often make it hard for outsiders to tell whether the SEC is being tough or lenient. But Pitt must go out of his way to make it clear that the Enron case is handled by the book—getting the same strict scrutiny from the SEC as any other, less connected company.

For now, top SEC aides say that's happening. The SEC Enforcement Div. in Washington is looking into whether Enron adequately disclosed to shareholders the risks of its complex deals with Andrew S. Fastow, the company's former chief financial officer. Agency insiders say Pitt and his fellow commissioners will be briefed on the case as it proceeds. But they insist Pitt hasn't heard from the White House or Enron's other political allies.

TOP LOBBYIST. Enron's connections are numerous. Besides Lay's links to Bush, an Enron director, Wendy Lee Gramm, is the wife of Texas Senator Phil Gramm, top Republican on the Senate Banking Committee. And Enron spreads its lobbying budget—\$2.13 million in 2000—across both parties. Just this year it hired four lobbying firms with Democratic roots. Enron says it lobbies heavily because it operates in regulated industries. It

notes that electric utilities outspend it 35 to 1.

On Oct. 31, a special committee of Enron's board hired William R. McLucas, former SEC enforcement director, to represent it. McLucas

should know that any attempt to muscle the stock cops is likely to backfire. Pitt, who joined the SEC out of law school in 1968, "remembers how the [Nixon-era] SEC tainted itself by turning a blind eye to [fugitive financier] Robert Vesco," says an agency veteran. Pitt has too much riding on the Enron probe to let its connections sway his judgment.



CHAIRMAN PITT

The Bush appointee has to show that Enron gets the same scrutiny as less connected outfits

to President George W. Bush create real risks for the SEC. Enron CEO Kenneth L. Lay is a longtime Bush backer, and the company was the biggest corporate contributor to the President's campaign. A Bush appointee, Pitt is attempting a delicate balancing act. He has made it clear he wants to speed up the SEC's enforcement, in part by rewarding companies that cooperate with probes. But he insists the SEC will still come down hard on true corporate miscreants—and knows that any signs of let-up could jeopardize the rest of his reform agenda.

Enter the Enron probe. The fine shadings of securities enforcement—

McNamee covers finance in Washington.

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HOLDING THE REINS

Chairman David-Weill must reconcile the New York and European houses—and create a succession plan

Lazard's woes worsened. Fights broke out over the profit split among New York, London, and Paris, and frustration mounted over the reluctance of imperious Chairman Michel David-Weill to share control. Now, the question is whether the discord will push David-Weill, 69, to create a viable succession plan.

Insiders say Loomis quit because he lacked the authority to shake up the firm and restore its role as the indispensable transatlantic dealmaker. But one person close to the bank says Loomis may have grown weary of the battle: "Bill's been here for 24 years. Maybe he didn't want to go through another struggle." Loomis, who wasn't available for comment, will

stay on as a nonequity partner.

Loomis had a tough task. The merger David-Weill forced on the three houses in early 2000 ran into major problems after the broad market downturn. The deal valued the New York office, traditionally the big moneymaker thanks to its roster of blue-chip American clients, at three times the assumed value of the French and British operations. That meant the American partners got the lion's share of the firm's income. Yet thanks to such coups as the Lazard-engineered takeover by Pirelli of Telecom Italia, Europe now makes up 77% of the firm's global

mergers-and-acquisitions business, compared with 59% in 2000. Lazard's U.S. M&A deals total only \$14.5 billion year-to-date, compared with \$44 billion a year ago. Lazard's New York office has offset a chunk of its lost M&A work

through its restructuring practice. Nonetheless, on Oct. 31, Lazard announced that it will lay off 50 of its 200 New York bankers.

Rebalancing the merger terms is fraught with dangers, since that would alienate the New York crowd. "At the same time," says a European partner, "if you don't rebalance, you're going to continue losing [European] partners. The cake is just too small." Compounding the problem is Lazard's ownership structure, which hives off 40% of earnings to David-Weill and a band of allied families called "capital partners."

What does Lazard need? Almost everyone says strong leadership—to bring in business and to ensure a successor to David-Weill, who has held the reins since 1977. That's easier said than done. Ex-Morgan Stanley Dean Witter & Co. exec John J. Mack was considered for Loomis' job, but he went to Credit Suisse First Boston instead.

WHO'S NEXT? David-Weill has also approached dealmaker Bruce Wasserstein, who sold his own investment bank in January. Sources say Wasserstein declined. "Who would take this job?" asks a close ally of David-Weill. "Bruce would demand absolute control, and I don't think Michel would give it." Then there's Gerardo Braggiotti, who left Italy's Mediobanca in 1997 for Lazard. He masterminded the Pirelli-Telecom Italia deal and is one of the firm's most talented European rainmakers.

One source contends Lazard isn't as immutable as it appears. David-Weill knows he needs a strong successor, this person says. "Things have changed.

Michel's not getting younger, and he's not a stupid man by any means." Would Lazard sell out to a big investment bank when business turns up? Insiders note that partners would get very rich from selling their interests. The Lazard saga is far from over.

By John Rossant in Paris, with Julia Lichtblau and Susan Zegel in New York

INVESTMENT BANKING

CAN ANYONE RUN LAZARD?

he CEO's departure spotlights internal rifts

A year ago, investment bank Lazard Frères seemed to be getting its house in order. To smooth discord between the recently merged New York and European branches, William R. Loomis, a Lazard veteran, was appointed the united firm's first American chief executive officer. The bank made several other moves, including setting up a generous compensation plan to stem high-level defections after key New York partner Steven Rattner left in March, 2000.

Today, none of that seems to have made much difference. Lazard is adrift again—just as the entire investment banking business is going through its toughest patch in at least a decade. Loomis resigned on Oct. 24 "to pursue other interests." Says one senior partner: "We all supported Bill. He was saying the right things, and we felt it was going to work." But under Loomis,

Steep Slide

The global M&A slump has hit Lazard hard

	DEAL VALUE BILLIONS	
	2001*	2000*
GLOBAL	\$83.8	\$220.3
EUROPE	64.6	129.6
U.S.	14.5	44.0

*Through 10/31 Data: Dealogic Data

COMMENTARY

By Amy Borrus

KEEP AMERICA'S GATES OPEN. JUST WATCH THEM BETTER

The Twin Towers are gone. But still standing tall in New York Harbor is the Statue of Liberty, symbol of America's embrace of immigrants from around the world. Ever since September 11, though, the growing distrust of Middle Easterners is threatening the country's open-door policy. A mid-October CNN/USA Today/Gallup poll found that 58% of adults surveyed wanted immigration reduced, a sharp rise from 41% just four months earlier.

In Washington, Congress has moved to toughen border controls, while President Bush on Oct. 29 announced that a foreign-terrorist task force would keep closer scrutiny over those on student and work visas. Some lawmakers are even calling for a temporary halt in issuing visas. Bush also has pushed to the back burner an initiative aimed at amnesty for millions of illegal Mexican workers and temporary work visas for thousands more Mexicans.

DRAGNET. No question, the U.S. needs to tighten up procedures for issuing visas and more closely monitor foreigners here (table). But yanking the welcome mat would be a mistake. True, a guest-worker program seems less urgent now that rising joblessness is dampening the need for workers. But before all foreigners get caught up in a dragnet atmosphere, it's important to make distinctions among the issues.

Legalizing some of the 8 million or so illegal aliens in the U.S. would not threaten national security. To the con-



JUAREZ: Beefing up patrols did not curb illegal crossings

trary, it would bring more people out of the shadows and establish a paper trail for them. Also, given the sheer numbers of foreigners entering the U.S. each day, Washington should put more resources into screening suspected wrongdoers before they reach the doorstep. "U.S. border security starts abroad," says Demetrios G. Papademetriou, co-director of the non-partisan Migration Policy Institute. "The best defense is good intelligence that's shared in a timely fashion" with U.S. consular officials overseas who review visa applications.

While tighter border controls are an understandable first reaction to September 11, they aren't an efficient way to keep out the bad guys. More than 350 million foreigners enter the

U.S. annually, including thousands who live on one side of the border but work or shop on the other. Closer inspections at the Mexican border have created seven-hour waits, which isn't sustainable. "Trying to find a terrorist among the vast numbers of people who enter every day is enormously difficult," says Theresa Cardinal Brown, an immigration expert at the U.S. Chamber of Commerce.

Similarly, fortifying border patrols to thwart anyone from sneaking in won't do much. The just-enacted anti-terrorism bill calls for a tripling of the 800-odd agents and inspectors on the 4,000-mile border with Canada. But the wave of illegal Mexican immigration in the 1990s occurred despite a threefold increase in patrol agents

RETHINKING IMMIGRATION

How to increase security without closing the door too tight

WHAT WE SHOULD DO...

SHARE INTELLIGENCE U.S. officials abroad who process visas need better access to FBI databases to screen out suspects.

USE MORE TECHNOLOGY Washington should help other nations adopt machine-readable passports. Facial-recognition systems could help verify passport photos.

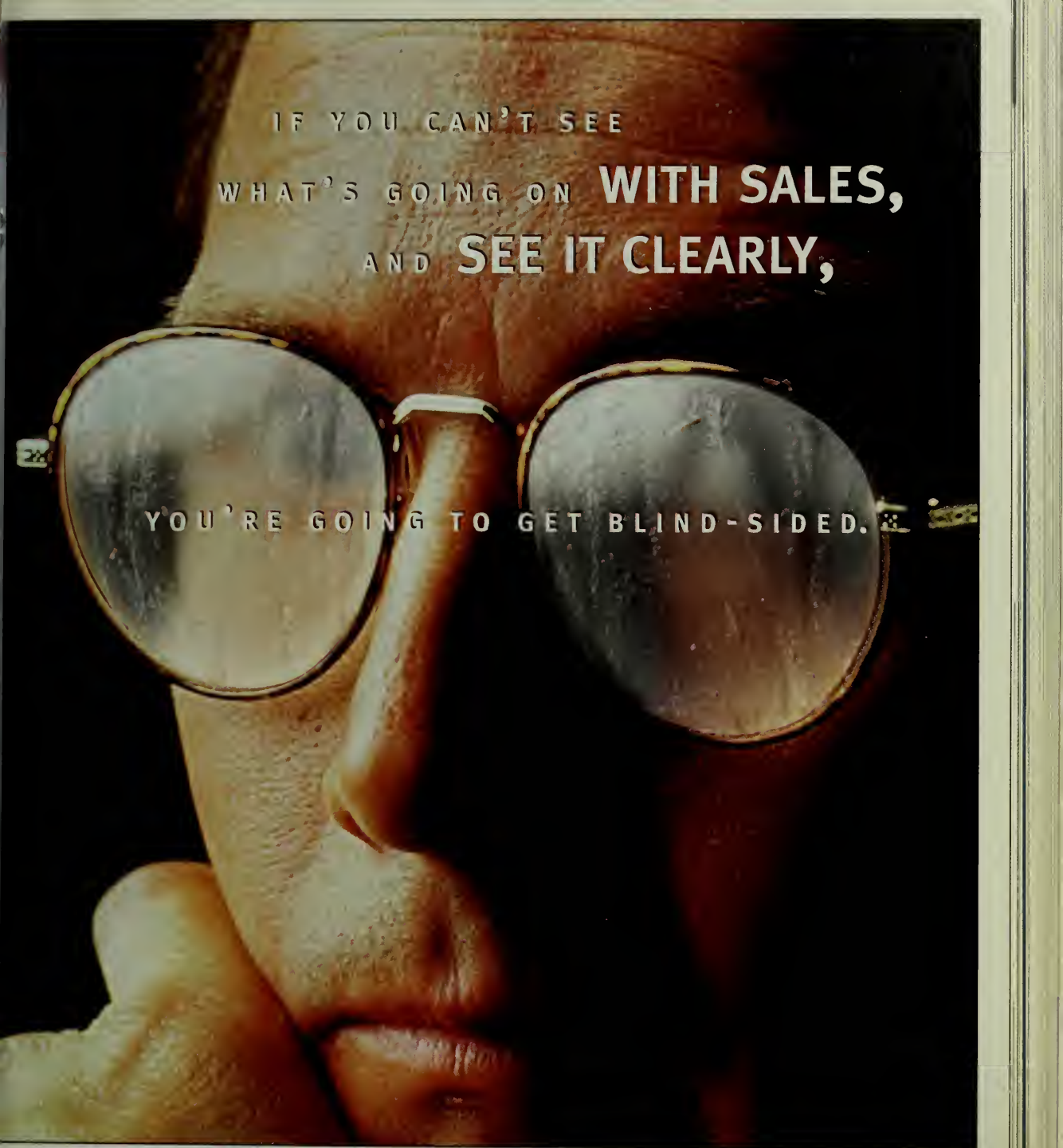
MONITOR FOREIGN STUDENTS Expand a pilot program to monitor the 500,000 foreigners in the U.S. on student visas.

...AND WHAT WE SHOULDN'T

REDUCE VISAS Cutting temporary or immigration visas would anger allies at a critical time and could hurt the economy.

GIVE UP ON AMNESTY U.S. security would benefit from bringing many of the 8 million or so illegal immigrants now living in the U.S. out of the shadows.

RELY ON BORDER CURBS to thwart terrorists. It's better to screen out wrongdoers at U.S. consulates abroad.



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along the southern border, to nearly 9,000. If hundreds of thousands of poor Mexicans can sneak into the U.S. each year, so can a terrorist with a sophisticated support network.

Closer scrutiny beyond the borders is key. Better intelligence might have prevented many of the 19 suspected hijackers from entering the U.S. with legal visas. A 1996 law gave consular officials access to FBI and other databases of suspected terrorists. But in practice, intelligence and law enforcement agencies have shared watch lists sparingly. Bureaucratic rivalries are one reason. Police mistrust of consular staffers, who tend to be junior officials, is another. Until frontline officials have suspects' names, they won't know whom to look for.

SMART PASSPORTS. Better access to intelligence and law enforcement databases would also help to shorten inspection lines at borders and airports. In addition, inspectors should have facial-recognition and other advanced systems that make it easier to spot false passports. To help free up resources, the U.S., Canada, and Mexico could encourage frequent travelers to submit to background checks and obtain biometric data-based "smart" passports that would pre-clear them for speedy entry to NAFTA states.

While Congress is right to zero in on security, that's no reason to penalize all immigrants. Before September 11, Bush and Mexican President Vicente Fox discussed legalizing the 4 million illegal Mexicans in the U.S. Granting them residency would give officials a better way to track any they thought to be suspect.

Given the porousness of U.S. borders and the volume of international traffic, sealing off the country would be a formidable task. The U.S. must balance national security needs with other values. "It would be a tragedy if we close the door on America's tradition of welcoming immigrants," says Daniel T. Griswold, an associate director at the Cato Institute, a conservative think tank. Let's not make immigration another casualty of the September 11 horror.

Borrus watches immigration issues from Washington.

Government



IN MEMORIAM:
World Trade
Center mourners

TORT REFORM

SEPTEMBER 11: HERE COME THE TRIAL LAWYERS

Efforts to limit litigation are pitting Bush against the bar—again

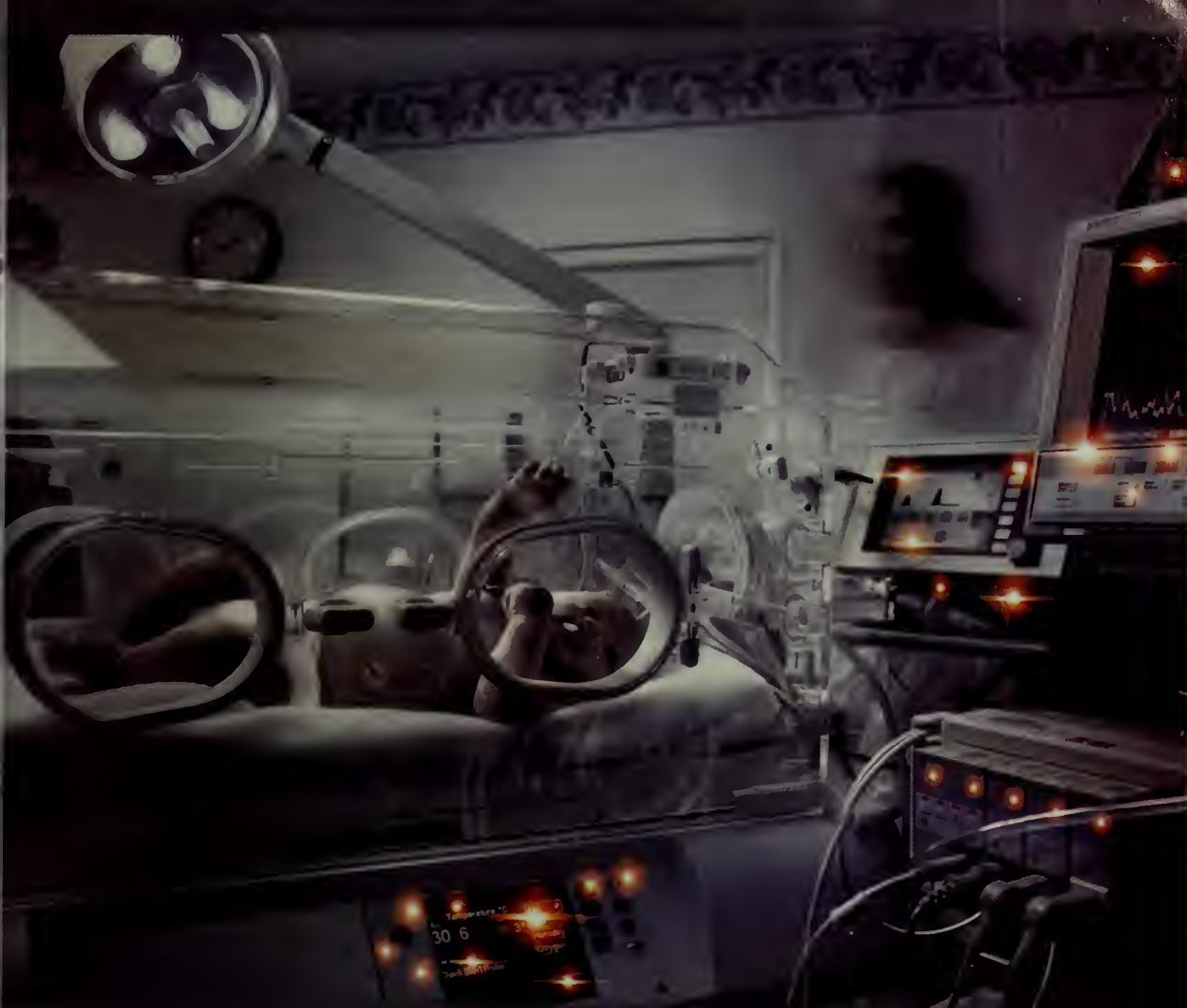
As a shocked nation linked arms after September 11, conservatives and trial lawyers seemed to forge an uneasy truce. Congress created a government-supported victims' compensation fund for people who opt not to sue in the wake of the terror attacks, and the Association of Trial Lawyers of America stepped in to provide free counsel for them. What's more, ATLA urged its members to suppress their ambulance-chasing impulses and adopt a 45-day moratorium on soliciting terror-victim clients. For a fleeting moment, it looked as though mass litigation might be avoided.

If anyone expected an enduring peace, though, they failed to check with the likes of New York lawyer Lee S. Kreindler. A veteran of lawsuits filed after the crashes of Pan Am Flight 103 and TWA 800, Kreindler has already lined up 30 September 11 clients and

is talking to dozens more. Why wouldn't we sue, asks Kreindler. "This is our livelihood."

Attitudes like Kreindler's are a big reason why the Bush Administration is stepping up its campaign against trial lawyers. In legislation adopted in September, the Administration was able to shield United Airlines Inc. and American Airlines Inc. from any liability above the \$6 billion in insurance carried by the four planes crashed in the attacks—a paltry sum when measured against the thousands of dead and injured and the tens of billions of dollars in property losses and damage to commerce.

Now, President Bush is actively seeking legislation to shield other companies. The Administration would like first to protect two other likely targets of litigation, World Trade Center property manager Larry Silverstein and Boeing Co., maker of all four planes. Silver-



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ein, a big Democratic donor, also has the support of Senator Hillary Clinton. Eventually, the White House may seek suits on liability for all companies vulnerable to litigation. Bush economic adviser Larry Lindsey says that without suits, property and casualty insurance companies will balk at issuing policies, causing major disruptions in an already shaky economy. "Unless there is some limit on proportionality of damages caused by terrorism, the [insurance]

WHAT THE VICTIMS' FUND DOES

To compensate September 11 victims and forestall a class-action free-for-all, Congress created a special fund. Here's how it works:

WHO IS ELIGIBLE? Any survivor or family of a victim. Aid is based on the victim's lost income, minus pensions and life insurance policies. Those who take the money agree not to sue. Those who sue forfeit their right to the fund. All suits must be heard in federal court in New York.

WHO IS MOST LIKELY TO SUE? Families of those on the plane that crashed in Pennsylvania. Since only one died on the ground, they have exclusive rights to some or all of \$1.5 billion in insurance the plane carried. Anyone whose loved one had a large life insurance policy is a good bet, too, since the fund might not provide them much help.

WHO IS MOST LIKELY TO BE SUED? United and American for sure. But their liability is limited to a total of \$6 billion of insurance on the four planes. World Trade Center manager Larry Silverstein, Boeing, and airports where the flights originated are possible targets as well.

market can't function," Lindsey says. Nor does the anti-litigation campaign stop with victims of September 11. The president has signed an executive order giving Health & Human Services Secretary Tommy G. Thompson greater powers to indemnify drugmakers called upon to make vaccines—such as the ones for anthrax and smallpox—known to cause adverse reactions in some patients. Bush's aides, meanwhile, are negotiating with key lawmakers, including Senate Majority Leader Tom Daschle (D-S.D.) and Senator Edward Kennedy (D-Mass.) (page 65), to come up with legislation that places caps on vaccine liability. The early handicapping is that broad limits will be adopted. Without such protection, says Lindsey, "apacious" trial lawyers will keep essential vaccines off the market.

OTHER AGENDAS? Tough language like that has many legal experts wondering if conservatives are using the tragedy for their own agenda. "The pro-tort reform forces are clearly jumping at the

opportunity," says Joanne Martin, associate director of the American Bar Foundation, an independent organization that monitors legal trends.

ATLA President Leo Boyle insists the vast majority of lawyers have been proceeding "very thoughtfully." By lobbying for the compensation fund and providing more than 1,000 pro bono lawyers, he says, ATLA is cutting off its own members from what could be billions in contingency fees. And for this, he says, he's getting nothing but grief from the Administration.

Boyle may have a hard time keeping his troops in line. Kreindler, for one, is rushing to sign up families of passengers on the plane that crashed in Pennsylvania: They won't have to compete with anyone on the ground for \$1.5 billion in insurance. Also of interest are those who lost loved ones in the Pentagon crash and relatives of anyone who had a large life insurance policy—which will be counted against any compensation they might receive from the fund.

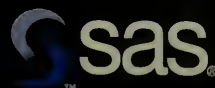
The likely first targets of Kreindler and his fellows: United, American, the World Trade Center managers, and Boeing. But the litigation won't stop there, lawyers predict. "They'll sue the federal government, the building engineers, the property managers," says critic Victor E. Schwartz, a partner with the Washington firm of Shook Hardy & Bacon. If the drugmakers aren't shielded from liability, they'll go after them as well, he predicts. "In the Oklahoma City bombing, they even sued fertilizer makers," Schwartz says.

Ironically, another reason for a barrage of lawsuits is the fund itself. The fund can take care of the majority of victims while allowing the trial lawyers to cherry-pick the best cases, says Glenn G. Lammi, chief counsel for the Washington Legal Foundation, a conservative group. In trying to keep litigation to a minimum, Congress may have played right into the trial lawyers' hands.

By Dan Carney, with Lee Walczak, in Washington

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TELECOMMUNICATIONS

THE BELLS AREN'T RINGING

Economic and telecom woes show up on their bottom lines

Just a few months back, the Bell phone companies were the aircraft carriers riding calm above the roiling seas of the telecom market. While the rest of the industry foundered, the Bells steamed ahead during the telecom turmoil of 2000 and the first half of 2001. Upstarts such as 360networks and WinStar filed for bankruptcy protection, and long-distance carriers AT&T and WorldCom saw their stocks plunge. All the while, the Bells cranked out profits, revenues steadily increased, and their stocks held up. "The Bells were the survivors," says Scott Cleland, CEO of researcher Precursor Group. "They were the only things that hadn't sunk."

Now, they're starting to list. With the release of their third-quarter financial reports, BellSouth, Verizon, Qwest, and SBC have shown that they are more vulnerable than many analysts had expected. Their revenue growth is slowing, profits are declining sharply, and their stocks, as a group, are down 25% from their peak last year. Most worrisome, their core businesses, which were supposed to be so steady, are starting to shrink. The number of local phone lines declined about 1.3% in the third quarter. And the average number of minutes customers used each line fell just less than 1%, according to Morgan Stanley Dean Witter & Co. figures.

On top of that, growth in the Bell new businesses is slowing. Local phone companies added 432,000 new digital-subscriber-line (DSL) customers during the third quarter, down from a peak of 559,000 during the fourth quarter of last year. Revenues from data traffic grew 18% during the third quarter. Not bad, but it's a marked slowdown from the peak of 25% during the fourth quarter of 2000. Even wireless service is looking less like the superstar. The Bell wireless businesses grew by 942,000 new customers during the third quarter, compared with 2.1 million during the fourth quarter of 2000.

SEA CHANGE. Certainly, the downturn in the economy is affecting the Bells. But the economy alone can't account for all their troubles, particularly in the core local phone businesses. What's happening is that, after 100 years of steady growth, the local phone business is going through a sea change. New technologies—wireless phones, e-mail, instant messaging, and cable modems—are siphoning business off of the old telephone network. Consultant Eastern Management Group estimates that new technologies account for 10% to 15% of communications that would have traveled over the traditional phone network two or three years ago, and that figure will grow over time. "A reduction in [Bell access lines] may begin to characterize the industry from now on," says Robert A. Saunders, a senior analyst at Eastern Management.

The shift could cost the Bells their position as leaders of the telecom industry. Today, Verizon and SBC have market capitalizations of \$134 billion and \$128 billion, respectively—more than twice as much as AT&T's, which, at \$55 billion, is the largest of the long-distance players. Many experts anticipate that the Bells will buy up these B. Three long-distance companies over the next year or two. But if the Bells' core businesses continue to shrink and the wireless and data businesses grow more slowly, they may not be able to pull off the acquisitions. The Bells may revert to performing like sleepy utilities, with sin-

LOCAL PHONE PROSPECTS SOUR

The Bell companies are starting to stumble. Growth rates are slowing for old and new businesses alike

LOCAL PHONE SERVICE

The number of local phone lines operated by the Bells declined about 1.3% during the third quarter, compared with a gain of 1.1% last year.

DATA

Sales of corporate data-networking services slowed, too. Revenues from data grew an estimated 18% in the third quarter, down from 25% in the fourth quarter of 2000.

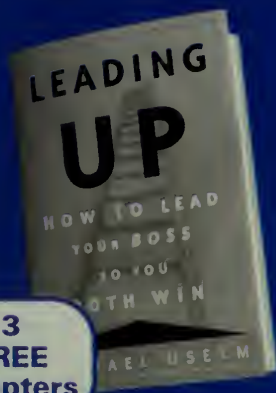
DSL

The Bells added 432,000 new high-speed Internet access customers during the third quarter, down from a peak of 559,000 in the fourth quarter of last year.

WIRELESS

The Bells' wireless businesses added 942,000 new customers during the third quarter, down from a peak of 2.1 million reached during the fourth quarter of 2000.

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COMMENTARY

By Andrew Zimbalist

WHY 'YER OUT! IS A BAD CALL FOR BASEBALL



EXPOS VS. MARLINS: Both teams could be history if the MLB shrinks

gle-digit revenue growth. If the stock market begins to reward fast-growth companies again, the Bells will lose their positions of relative strength. "The Bells only looked good because the telecom landscape around them was so devastated," says Mark Herskovitz, senior sector manager for telecom investments at mutual-fund giant Dreyfus Corp. who is reducing his Bell investments. "But when the larger telecom sector begins to come back, the Bells will look stodgy again, and their stocks will wilt."

Hogwash, say Bell execs. The softness, they argue, is due mostly to the economy. Although there is a fundamental shift in communications under way, they maintain that money coming out of one Bell pocket is simply going into another. People may use the traditional telephone networks less, but the Bells have 45% of the wireless market. Verizon Wireless is the largest provider of wireless service in the country, with 25% of the market. The Bells also reap revenues from new data services, including speedy Net access using DSL technology. "We're riding the wave of substitutable technology, which I think makes a lot of sense," says Ivan Seidenberg, president and co-CEO of Verizon Communications.

EROSION. It isn't that simple. The Bells have a near-monopoly on their local telephone businesses, where gross margins are about 45%. In the wireless market, competition is fierce, and gross margins are about 35%. This means that, even if the Bells get the same share of the wireless business that they have on the wireline side, their profits will suffer. That business "isn't coming back," says telecom analyst Simon Flannery of Morgan Stanley Dean Witter & Co.

A similar erosion is taking place in Internet services. In the past, when consumers started using the Net, they often bought second and third phone lines. That helped drive the growth of local phone lines to 4.5% in 1999 and 1.1% in 2000. Now, many U.S. households are signing up for high-speed Net access—more than 10 million have broadband connections so far. That creates a problem for the Bells on two fronts. First, about half of all high-speed Net surfers disconnect their second phone lines, Flannery says. What's more, the Bells are getting trounced in the broadband game. The cable companies are grabbing two new broadband customers for each one the Bells get, analysts estimate. "In the long run, that's an issue for [the Bells]," says Austan Goolsbee, a professor at the University of Chicago's Graduate School of Business.

The Bells may not wind up the winners of the telecom wars after all.

By Charles Haddad in Atlanta

Will Major League Baseball downsize after the World Series? Commissioner Bud Selig, asked to say it ain't so to a spate of rumors, will concede only that the question of whether to eliminate two teams could be considered as early as a Nov. 6 owners' meeting.

Contraction certainly has some allure for the Lords of the Game. With two fewer low-revenue teams, the share-the-wealth levy on rich clubs would be reduced. And there would be two fewer teams with little or no chance to participate in the postseason. But revenue-sharing would not be eliminated, and there would still be plenty of teams without a prayer of making it to the Series. More important, reducing the roster of clubs from 30 to 28 would create enormous problems.

Any attempt to eliminate, say, the Montreal Expos and the Florida Marlins (or the Minnesota Twins), is sure to rouse a posse of state attorneys general, aspiring owners, the players union, and members of Congress. If the Expos head for the last locker room, for example, it means the team won't relocate to Northern Virginia, Sacramento, Las Vegas, or Portland, Ore. If the Marlins fold, it may provoke Florida to sue MLB on antitrust grounds for attempting to decrease output in the face of healthy demand.

More important, the players union, which stands to lose 80 members—major-league rosters have 40 players, though active rosters are 25—won't stand still for contraction. Contract talks are scheduled to begin after the postseason, and any attempt to shut down teams will land on the bargaining table.

At the least, baseball would face a

public-relations minefield. The courts or Congress would likely decide that baseball is acting in bad faith and narrow the antitrust exemption that allows it to, among other things, maintain restrictive labor practices in the minor leagues.

PLAY OR PAY. There is also the matter of paying for the shuttered franchises. Each owner would want at least what they paid for their teams, plus any accumulated book losses suffered—a sum that may reach \$400 million. Further, paying off affiliated minor-league franchises would cost about \$60 million more.

Then there's the question of rational business strategy. Most businesses, even monopolies, like to expand into new markets. Wouldn't MLB's national TV ratings go up if there were more baseball fans in Washington, Las Vegas, or elsewhere? Wouldn't national licensing of MLB products be given a fillip?

Finally, has anyone noticed that the Barry Bonds, Mark McGwire, and Sammy Sosa assaults on the home-run record have all come after the 1998 expansion to 30 teams? There is a good statistical reason for that. The so-called talent dilution from adding 50 major leaguers was just enough to give these sluggers the edge that put them over the top. Challenges to longstanding records are fun, and they crank up fan interest. Go back to 28 teams, and baseball gets duller.

Zimbalist is the Robert A. Woods Professor of Economics at Smith College. His latest book is The Economics of Sport.

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HANDHELDS

Tour the expanding universe of PDAs, and the apps and add-ons that make them seem indispensable **PAGE 124**

PHONES

Weigh wireless providers, hybrid handheld gizmos, cell-phone headsets, and disposables **PAGE 130**

COMPUTERS

Find lightning-quick laptops, desktops that deliver XP, flat displays at lean prices, and cybervisors **PAGE 138**



techTV

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FRESH GEAR



A HANDHELD FOR EVERY POCKET

They come in all shapes, sizes—and prices

When animal-control officers in Lincoln, Neb., pick up a stray dog, they can enter its license-tag number into a Palm VII wireless handheld and instantly see any information on the animal from records stored on an IBM mainframe back at the office. Lincoln's tax assessors can use Palms to look up the history of a house they're appraising. Soon, the city's parking-enforcement officers will brandish

handhelds, checking license plates in their search for scofflaws and even verifying that a plate matches a vehicle identification number.

The 50 Palms deployed by the city of Lincoln, and the hundreds more that the city hopes to put in the field, show how much handhelds

have evolved. Once merely a handy way to carry an electronic address book and calendar, they are now valuable tools for the mobile worker.

These days, handhelds offer a low-cost solution for a complex business problem. Why did Lincoln choose Palms? "They're affordable," says Terry Lowe, project supervisor in the city's Information Services Div. "We're talking hundreds of dollars instead of the thousands we pay for the mobile data terminals used by the police." The cost of a Palm V, which will be replaced early next year by an improved version, is down to \$200, plus wireless service starting \$10 a month.

If you're in the market for a handheld computer, you're in luck. The number of choices has exploded this year with new models emerging in all sizes, shapes, and price ranges. If you need a constant connection to your e-mail, you can get a handheld with wireless service, or you can add the service later. A growing number come with color screens. Whether you are looking for the elegance and simplicity of a Palm, the sophistication and flexibility of a Pocket PC, or the single-minded e-mail efficiency of a BlackBerry pager, there's undoubtedly a handheld that's right for you. Best of all, prices are coming down fast. A year ago, Palm's slim V model sold for \$400. Today, its more capable successor, the m500, goes for \$329.

VAST MENU. Despite the profusion of models, choosing a handheld isn't difficult. First, assess your basic needs, and choose the type that fits the best—wired or wireless, Palm or Pocket PC. Then go for the extras best suited to your tastes and your budget. Is gee-whiz color screen worth the extra money and short battery life? Do you want rechargeable batteries, or a throwaway alkalines O.K. Are you interested in the wealth of free consumer software available for Palms, or the ability to tap into corporate e-mail and databases offered by a Pocket PC?

Lots of people are content with the original Palm concept of a "connected organizer" that shares data with a PDA, but when DayTimer offered a deal on a Palm 100, I thought I'd see what y kids were raving about," says medical consultant Larry ib of Oconomowoc, Wis. "I came addicted overnight." syncs with the DayTimer ftware on his desktop PC. e subscribes to the Palm rsions of CNN, *The New York Times*, *BusinessWeek*, d the Weather Channel. He s added a spreadsheet program, TinySheet from Iambic ftware, for \$20, as well as aps from Mapopolis, a scientific calculator, and tables looking up telephone area des. All fit in the Palm's ltry 2 megabytes of memo- His favorite feature? "The tteries last for weeks," says.

IMMER. There are now out two dozen models from her Palm or the seven mpanies that license its op- ating software. Palm's own e runs from the \$149 m105 the \$449 m505, a slim model with a color display. e newest entrant is the drange m125. At \$249, its ly major departure from e \$329 m500 is the use of A batteries instead of chargeables. All of the m- ries Palms, except the 100, me with an expansion slot. e-called Secure Digital (SD) rds that fit the slot offer her extra memory or programs, such as city guides or ndheld games. Eventually, cards will be able to han- e communications options ch as a wireless modem. Palm rival and partner andspring also has filled out portfolio. The \$199 Visor o is a bit thicker and heav- r than the Palm m125, but costs \$50 less and features uch wider expansion possi- lities with its Springboard ot. Springboard options include wireless modems, GPS ceivers—even a massager.

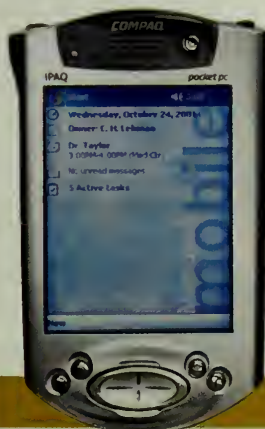
The rechargeable Visor Pro, at \$299, features 16 MB of internal memory, twice that of most models. Meanwhile, the cost of the color Prism has been cut from \$449 to \$299.

Newer entrants to the Palm family also are making their mark. Sony caused a splash earlier this year with its \$499 CLIE model boasting a brilliant color screen. Now, it has a \$300 monochrome version, which features the same stylish design plus a

long-range infrared port that lets it do double duty as a universal remote control for your TV, VCR, DVD, and stereo. That should be in stores by late November.

If access to corporate networks and integration with desktop applications such as Microsoft Office are a priority, you might be happier with one of the Pocket PCs. These are more capable—albeit at a cost in weight, price, and complexity. The latest models, based on Mi-

COMPAQ IPAQ



crosoft's Pocket PC 2002 software, feature big improvements in their e-mail programs and in their ability to connect to corporate networks.

David T. Bowman, a business development manager for an electrical contractor in Chesapeake, Va., was a long-time Palm user who became frustrated with its limitations, especially in synchronizing

with Microsoft Outlook mail and contacts. He switched early this year to a Casio Cassiopeia EM500 Pocket PC and is considering moving to a Pocket PC 2002 from Hewlett-Packard. "The best feature is the ease of communication between my laptop organizer software and the Pocket PC," Bowman says.

FRESH BATCH. He's especially pleased by how well the Pocket PC works with Microsoft Outlook's database. "This is a big advantage over the Palm," he says. Bowman uses his Casio for e-mail, even though he doesn't use wireless or even a standard modem. He just downloads his e-mail when he syncs and then reads and writes messages off-line.

The newest batch of Pocket PCs from Compaq, HP, and Toshiba—with more models due soon from NEC and Casio—should continue making inroads into Palm's longtime

THE HOTTEST NEW PDAs

MODEL / COMPANY	PRICE	UNIT SIZE / SCREEN	THE SKINNY
PALM FAMILY			
m125 Palm Inc. palm.com	\$249	4.8x3.7x0.9 Monochrome	Newest entry-level Palm has expansion slot, just like the more expensive ones.
VISOR PRO Handspring Inc. handspring.com	\$299	4.8x3.0x0.7 Monochrome	This new model brings the price for a 16-MB rechargeable handheld to a new low. Free Visor Phone with activation of service.
TREO 180 Handspring Inc. handspring.com	\$399 with service activation	4.3x2.7x0.7 Monochrome	Handspring's take on the flip-phone with a Palm built in (available early 2002). Comes in keyboard and traditional Graffiti versions.
CLIE T415 Sony Electronics sonystyle.com	\$299	4.6x2.8x0.4 Monochrome	Thin and light. Can also work as a universal remote control for your TV and stereo.
POCKET PC FAMILY			
IPAQ 3800 Compaq Computer compaq.com	\$599	5.3x3.3x0.6 Color	The coolest Pocket PC gains an internal memory slot, keeps accessory sleeve for broad expansion options.
JORNADA 565 Hewlett-Packard hp.com	\$599	5.2x3.0x0.7 Color	Sleek design with flip-up cover features the longest battery life, plus a removable battery.
e570 Toshiba toshiba.com	\$569	3.0x4.9x0.7 Color	Solid new entrant comes with two accessory slots to take either CompactFlash or SD expansion cards.

* In inches

Data: *BusinessWeek*, company reports

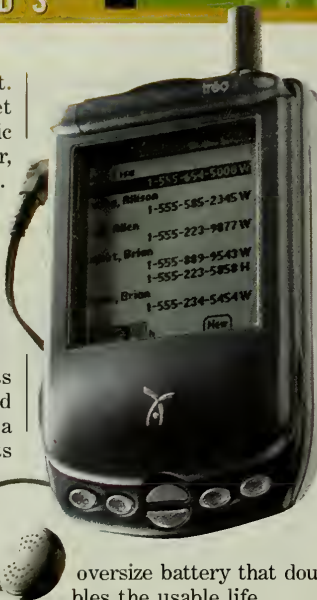
HANDHELDS

dominance of the market. Like the Palms, the Pocket PCs all run the same basic software for your calendar, address book, and e-mail. Even in terms of hardware, the products are more alike than different. The main variation is in the number and type of expansion slots, which determine what accessories you can use.

Compaq's iPAQ, with its striking industrial design and ultrabright screen, turned a lot of heads last year. Its new \$599 model 3800 remains the style leader. In addition to Microsoft's much better Pocket PC 2002 software, the 3800 has gained a built-in SD memory slot. If that's not enough, Compaq offers a variety of accessory sleeves that fit around the back of the handheld and, at the price of a bit of extra weight and bulk, let you use either CompactFlash cards or laptop-style PC Cards. The options can handle nearly any wireless communication, from a local area network to the Sprint PCS phone network.

SEXY. If you think you'll use a number of accessories, you should take a look at Toshiba's first entry into the handheld field. Its e570 has a design that is functional rather than sexy and comes in a bit cheaper than the competition, at \$569. It's also the only model with a pair of built-in slots that allow it to handle both SD and CompactFlash cards right out of the box.

HP's \$599 Jornada 565 is not quite so flexible—with only a single CompactFlash slot. But it can run longer on batteries than any other Pocket PC—as much as 14 hours between rechargings if you keep the screen's back-light turned down. That's enough for at least a couple of days worth of normal use. The Jornada is also the only Pocket PC to use a removable battery, with the option of an



HANDSPRING TREO: The first with a miniature keyboard

oversize battery that doubles the usable life. You can equip nearly all of these handhelds—Pocket PCs and the Palm family—for various types of wireless operation. Handsprings, most Palm models, and Sony's CLIE can use clip-on wireless modems to reach the Net. They'll put you on the data network operated by AT&T Wireless and Verizon Wireless. Tip: Early next year, most wireless phone carriers will launch higher-speed data services, so you might want to wait for the required new gear to come out. You can also buy adapters for any Handspring, most Palms, and any handheld with a CompactFlash slot that lets you work on a wireless local area network.

There are now handhelds masquerading as wireless phones. The first practical model was the Smartphone from Kyocera Wireless (about \$500 with activation from several different carriers). Samsung has gone Kyocera one better with its sleeker \$500 I300, just hitting the market now. The most exciting news in the Palm phone market comes from Handspring. Its new \$399 (with activation) Treo 180 won't be available until early next year but could be worth waiting for. It's a flip-phone design that's a bit wider than most phones, at 2.7 inches, but is narrower and shorter than any other Palm family device. The Treo is the first Palm to ditch Graffiti shorthand in favor of a miniature keyboard.

SINGLE-MINDED. All of these handhelds offer great flexibility at the price of complexity. By contrast, Research in Motion's BlackBerry thrives on its single-minded ability to handle wireless e-mail. It comes in two basic styles: a \$399 pager-size version and a larger model, about the size of a Palm, for \$499. Both use a tiny but surprisingly efficient keyboard.

The original BlackBerry service allows you to get corporate e-mail via a \$39.99-

per-month service. Several Internet service providers now let you get to your mail using the BlackBerry Internet Edition. For example, Earthlink offers unlimited mail service for \$39.95.

Because the BlackBerry is basically a pager, it is ideally suited for instant messaging. You can get Yahoo! Messenger on Motient's eLink service, which starts at \$24.99/month. The AOL Mobile Communicator is a modified BlackBerry 950 pager that handles AOL mail and instant messages. To spur sluggish sales, AOL has cut the price of the device to \$99, with unlimited wireless service for \$29.95 monthly fee above regular AOL membership.

Today, the overwhelming majority of handheld owners don't use their Palms or Pocket PCs to connect to anything but a PC—and they find them useful tools. But as the wireless options expand, and wireless data networks get better, and as the design wars figure out how to merge the functions of a PDA and phone into a device small enough to fit into a pocket, these Swiss Army Knives of the computing world will be the wave of the future. And someone who rarely leaves the office without a Palm, BlackBerry, and a phone, can't wait.

By Stephen H. Wildstrom in Washington

FRESH GEAR



SCOTT eVEST

Technology-enabled clothing

scottevest.com

\$120

Gadget junkies rejoice! There's finally a way to carry all your handhelds, keyboards, phones, and CD players stylishly. A techie version of the classic fisherman's vest, the Scott eVEST has 15 pockets, including stylus pockets and pockets-in-pockets to prevent rattles. And unsightly wires won't dangle with the vest's Personal Area Network, a system of Velcro-secured conduits that channel the wires from pouch to pouch.

75% OF ALL I.T. DOLLARS GO TO INFRASTRUCTURE.

ISN'T IT TIME YOU LEARNED WHAT IT IS?



Free field guide for elevator-conversation readiness.

COMPANIES TODAY HAVE A TON OF MONEY RIDING ON INFRASTRUCTURE. And it's not just the amount of money spent that's important, it's how wisely it's spent. So how do you ensure that your business model leads to profitability? Will the platform you invest in today work with the technology you'll need tomorrow? How do you protect it? How do you plan for the unexpected? How will you finance all this?

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GOLF BUDDY: "I improved my handicap from 14 to 10 with this," says Dr. Mark Reed of his SkyGolf

handheld. You can get e-guides, monitor your stock portfolio at My Yahoo!, read headlines and stories from your favorite magazine and newspapers. One caveat: If you use a dial-up connection, AvantGo will slow down your sync, so you'll want to limit your selections to your top two or three sites.

DIRECTIONS. If travel guides are all you need, take a look at Vindigo software. It's easy to download (vindigo.com) and install on your handheld. Free for Palm and Visor users, while users of the jazz-oriented Pocket PC version pay \$299 a year. It gives you up-to-date details on restaurants, shopping, and entertainment in major cities. Just enter the intersection that's closest to you, and it will direct you from there. Like AvantGo, it updates every time you sync, so you won't find yourself stranded at a restaurant that has recently closed.

If you travel a lot, you know how cumbersome it is to tote around all that gear: laptop, handheld, cell phone, projector, printer, what have you. One way to pare back is Margi Systems' Presenter-to-Go. Compatible with PowerPoint and other map slide-making programs, Presenter-to-Go lets you design slide shows on your Visor or Pocket PC. When it's your turn on stage, you use the adapter it comes with to connect directly to a projector. The little remote control, included, talks to your handheld's infrared port, directing it to advance to the next slide. It's \$299, a reasonable price for the luxury of leaving your laptop at home.

What if you need to print when you're on the road? Pentax' portable PocketJet prints full-size pages, but 10 in. by 2 in., it's a little bulkier than you might like.

THE WHOLE WORLD IN YOUR HANDHELD

The latest add-ons can give you maps, a golf edge—even a massage

Ever wish for a massage at the end of a hard day? Or that you could afford a personal golf coach to trail you around the links? And what about when that craving for tekka maki strikes—where's a concierge who can direct you to the nearest late-night sushi bar?

Stop dreaming. Thanks to a growing number of software programs and accessories, your Palm, Handspring Visor, or Pocket PC can deliver all that and more. And don't forget about work: Handhelds are more than just

a place to store reams of appointments and addresses. Nowadays, you can deliver complicated business presentations on them—or even pop on a camera attachment to instantly capture images, then e-mail them to clients.

The best add-ons are easy-to-install software downloads, disks, or snap-on modules. Some are even free. The first-rate ones take full advantage of all the available technology—the ability to "sync," or back up your handheld's content on your desktop PC or the ability to swap data and

software via infrared beams.

There are a slew of programs that can turn your handheld into a traveler's best friend. AvantGo, for example, is a free download (avantgo.com) that gives you portable access to favorite Web sites even when you're not connected to the Internet. Just pick the sites you want. Then, whenever you hook up to your computer—provided you're connected to the Net—AvantGo automatically searches out the latest Web pages from those sites and stores them on your

pretty good alternative is iPix' Pocket Printer A6 for Palm, Visor, and Pocket PC. At 9 oz., and 4 in. by 5 in., it's easier to carry than a paperback. You can beam print commands to it provided you've created your documents using SiPix-compatible software, such as DataViz' Documents To Go. "I've impressed quite a few people by offering printouts during meetings," says Francis Lo, business-development manager for CLP Holdings, a Hong Kong utilities company. At \$179, it's also \$100 less than the PocketJet.

But beware—the slightestudge during the printing process can interrupt the connection to the printer. Tip: If you're bothered by the notepad-size printouts, have the hotel's business center photocopy them at 200% to get them to standard letter size. It's not laser-perfect quality, but it'll do in a pinch. Quality is also the rub for most of the digital cameras designed to be attached to handhelds. Visor Eye Module

Kodak's PalmPix, and Hewlett-Packard's Pocket camera for its Jornada Pocket PC snap right on to your



HOT STUFF: Raycom's Personal Massager with gel pads and HP's Pocket Camera, a standout among its rivals

handheld. They're all tiny and lightweight, and they make it easy to attach photos to documents or e-mail messages. But the HP product (\$140) is clearly the best. It's packed with extras, such as the ability to attach sounds to pictures. "The quality is on par with other digital cameras," says Sven Johannsen, a systems engineer for Computer Sciences Corp. in Colorado Springs, Colo. "Plus, because it's coupled with a little computer, you get image editing and manipulation capabilities."

Your handheld can act like a Walkman, too. With the free Audible Advisor software (audible.com) for the Visor and most Pocket PCs, you can download audio books from the Web site as well as

subscribe to radio programs such as *All Things Considered*. The popular daily radio show costs \$9.95 per month or \$59.95 per year. Make your purchase on audible.com, and your audio program will shoot right into your handheld the next time you sync. Audio-book prices are competitive with those charged by online booksellers, though the selection isn't as good. A recent Audible search for Amazon.com best-seller *Harry Potter and the Sorcerer's Stone* came up empty.

If golf is your passion, you've got to try SkyHawke Technologies' SkyGolf GPS. Designed for the Palm V, Vx, and all Visors, SkyGolf's GPS receiver snaps on to your handheld and turns it into a personal caddie. It calculates

the distance between your ball and the hole, automatically updating as you play the course. The U.S. Golf Association bans such tools in tournaments, but for practice and friendly games it's handy. "The more you know, the easier it is to pick the right club to get closer to the hole," says Dr. Mark Reed, a Jackson (Miss.) pediatrician. "I improved my handicap from 14 to 12 with this."

You can download maps of more than 600 U.S. courses from skygolfgps.com or, by following simple, onscreen instructions, configure the product to the course you're playing that day. And you can beam course maps to other SkyGolfers. It costs \$399—about what you would pay for a Big Bertha—plus an average of \$9.95 for each course map you download.

TINY FINGERS. And how about that massage after a day on the links? Give yourself a relaxing rub with the Raycom Personal Massager, a \$99 module for the Handspring Visor (no Palm or Pocket PC version yet). It comes with two gel pads, each about the size of a business card, that connect to your handheld via a 45-in. cord. Place them directly on sore muscles or acupressure points and the massager alternates among vibrating, squeezing, and tapping motions, with little animations on the screen to show you what's happening. You can even adjust the pressure. The pads are a tad small, but a five-minute session with your handheld masseuse will do wonders for a sore tennis shoulder or that cramp in your leg you get from sitting on an airplane.

So go wild. You may have thought your handheld was just a convenient electronic repository for all your business information. But now, it can be one of your best buddies, too.

By Arlene Weintraub in Los Angeles

BEST OF THE ADD-ONS

PRODUCT	PLATFORM	PRICE	THE SKINNY
FOR WORK...			
MARGI SYSTEMS' PRESENTER-TO-GO margi.com	All Visors and Pocket PCs with PC card slots	\$299	Turns your handheld into a slide projector, complete with an infrared remote-control slide flipper.
FOR PLAY...			
SKYHAWKE TECHNOLOGIES' SKYGOLF GPS skygolfgps.com	Palm V, Vx, and all Visors	399	With snap-on GPS, it becomes an electronic caddie: It tells you how far you are from the next hole—and helps you keep score.
FOR BOTH...			
HP POCKET CAMERA hp.com	HP Jornada Pocket PC	140	Slide this tiny camera into the top of your handheld and snap away, apply sound, make slide shows, and send to friends by e-mail or infrared.
AVANTGO'S MOBILE INTERNET SERVICE avantgo.com	All Palms, Visors, and Pocket PCs	Free	Automatically transfers updated pages from your favorite Web sites to the handheld every time you sync it.

Data: BusinessWeek, Company Reports

WIRELESS: PUT SERVICE FIRST

Be sure the provider best suits your needs

After Marissa Whitley won the Miss Teen USA contest in August, she left Springfield, Mo., moved to an apartment in New York, and traveled regularly around the country to appear at events. She was thrilled with her new life, but, as an 18-year-old who had lost both of her parents as a child and was now far from friends and family, she was also lonely. One day in September, she got a text message on her

mobile phone from her best friend. "It said, 'Don't forget about me in the Big Apple. We miss you. Love, Morgan.' That was probably the most memorable text message I've gotten," says Whitley.

If you want to know about the future, look to the young. What Whitley's experience shows is that mobile phones are not just for talking anymore. The major providers of wireless phone service, including Verizon Wireless, Cingular Wireless, and AT&T Wireless, are rolling out a

new generation of mobile phones with new services, including text messaging and wireless Internet access. "Messages are really easy and quick," says Whitley. "My phone is a lot more reliable for sending me a message than a computer, especially because I don't have a computer at home."

THE BASICS. Not that you should forget about voice communication. Clearly, the primary reason anyone gets a mobile phone is to gab away. Most people want to pick the

coolest phone they can find and then choose a service plan. My advice is to do the opposite. Choose a wireless service provider first, because the differences in the offerings are much greater than the differences in phones—and not every phone works with every wireless network. Once you find the service that's right for you, then pick a phone from the provider that suits your fancy—Nokia, Motorola, Samsung, or some other manufacturer.

Choosing a wireless ser-

vice plan can be a baffling experience. All the major players run promotions that trumpet features or advantages that you may or may not care about. Never mind all the marketing fluff. The key is to answer some basic questions: Are you going to use your phone primarily in and around your own city, or do you travel enough that you want to use it around the country? And will you use your mobile phone mostly during normal business hours, or do you plan to use it mostly on evenings and weekends? Once you answer these questions, you can make smart choices about which service is best for you.

For people who want to use their mobile phones near home, there are lots of good options. Let's assume you want to keep your mobile bill reasonable—say, \$40 a month. If you're going to use your phone during business hours, most of the per-minute rates are around 10¢.

Since prices are so similar, it makes sense to go with the phone companies that rank highest on quality. J.D. Power & Associates publishes an annual ranking of wireless carriers for 25 different markets, which can be found at

WHO YOU GONNA CALL?

Confused by mobile-phone plans? You're in good company. To sort through the maze, we took a hypothetical consumer who wants to spend about \$40 a

month on mobile-phone service and examined five plans. Prices are based on the New York market.

	VOICE PLANS		
	LOCAL PLAN*	NAT'L PLAN*	EXTRAS
AT&T WIRELESS	10¢ a minute	13¢ a minute**	With the local plan, you get unlimited free calling from 8 p.m. to 7 a.m. weekdays and on weekends. Short messaging is available. 10¢ a message or less. Most wireless Net services are free, but then you need a clunker of a phone.
CINGULAR	10¢ a minute	23¢ a minute	With a local plan, you get unlimited free calling from 9 p.m. to 7 a.m. during the week and all weekend. It also offers short messaging and wireless Internet services.
SPRINT	11¢ a minute	11¢ a minute	With its current promotion, you get 3,650 minutes a month to use from 8 p.m. to 7 a.m. during the week and all weekend. Also offers wireless Net services and short messaging.
VERIZON WIRELESS	9¢ to 10¢ a minute	23¢ a minute	With the local plan, you get 3,000 minutes per month from 9 p.m. to 6 a.m. during the week and all weekend. Also offers short mess
VOICESTREAM	8¢ a minute	8¢ a minute	You get 2,000 weekend minutes per month or unlimited weekend minutes if you sign up for a two-year plan. Its short messaging is the best, and it will be the first to introduce high-speed Net acc

*Local plans are without long distance and roaming, and the cost is for daytime hours only during the week. National



www.jdpower.com. It measures a host of factors, including coverage, call quality, and customer service, and then ranks the phone players on overall satisfaction. AT&T ranks tops in customer satis-

faction in 13 of the markets, including Los Angeles, Chicago, and Dallas. That's due to the company's customer service and call quality, among other things, according to J.D. Power. Verizon Wireless

ranks highest in eight of the markets, including Boston, Philadelphia, and Seattle. The top-ranked carrier in New York is Sprint PCS, a positive sign for the company since customers in the past have complained about poor coverage in some areas.

DISCOUNTS. If you're using your mobile phone around town and you expect to make lots of calls outside of business hours, you can get much more for your money. Wireless providers offer discounted service at night and on weekends, but the discounts vary greatly. With AT&T and Cingular Wireless' \$40-a-month plans, you get unlimited free calling on nights and weekends. Verizon, Sprint PCS, and VoiceStream offer 2,000 to 3,650 minutes.

If you're a big traveler, you're probably going to pay more for your mobile-phone service—but at least you can get widespread service. The wireless industry has consoli-

dated into five major players—six, if you count Nextel Communications Inc., which caters mostly to businesses—and all offer some kind of national service. The best options for national coverage are AT&T, Sprint, and VoiceStream. Sprint and VoiceStream are good low-cost choices, charging 11¢ and 8¢ per minute, respectively, for \$40-a-month plans. Their coverage is spotty, though, since both are new providers that haven't had as many years as other carriers to put up radio towers across the country. AT&T is the best option for people who don't mind paying a little more for higher-quality service—the lowest price national plan is \$60 a month. It charges 13¢ a minute for nationwide roaming and long distance.

Verizon and Cingular, a joint venture between BellSouth Corp. and SBC Communications Inc., offer national plans, but they're more

NNY

ay for quality with Ma Bell. Although its service isn't cheap, AT&T has the highest customer satisfaction of any mobile player, according to researcher J.D. Power.

d midrange option, especially since Cingular throws in free long distance with its local plan. But quality is mediocre, according to Power.

t's coverage has improved, but its rates are no longer that much better than rivals. Go to Sprint if you want affordable, nationwide coverage and long distance included.

or the bargain shopper. Verizon is expensive, but it ranked No. 2 in coverage and customer service, according to J.D. Power.

are bargain-basement, but look out for holes in coverage, including chunks of California, Virginia, and the Dakotas. You could end up paying 49¢ a minute—or simply go without coverage.

long distance and roaming. **AT&T's lowest cost national plan is \$60/month.

Technology: What To Buy

HANDHELD

PHONES

COMPUTERS



A MOBILE PLAYER: *Miss Teen USA Marissa Whitley likes the ease of text messaging*

expensive than rivals' plans. Their rates are 23¢ a minute for packages that cost about \$40 a month—perhaps because they don't want to cannibalize their local phone business. Verizon and Cingular are more competitive with national plans that run \$50 or more per month.

Which company is best for people who like sending and receiving text messages? Whitley uses AT&T, but all of the wireless players have decent messaging features. Often, you get a few free messages each month and additional messages typically cost 10¢ each. If you sign up for a bucket of messages, you can pay 3¢ a message or less.

There's one big drawback, however. None of the wireless companies lets you send messages to the phones of other wireless companies. In other words, AT&T customers can't send text messages to Sprint or Verizon customers. Why not? The mobile players simply haven't installed the technology to let their networks trade text messages. Clearly, this is a big draw-

back. It would be like AT&T Wireless customers not being able to call anyone who doesn't use AT&T Wireless service. The result is that only 5 or 6 million of the 120 million mobile-phone customers in the U.S. use messaging, according to estimates from researcher Gartner Group Inc. Text messaging will get more useful as carriers start to deploy technology next year for swapping messages among themselves. Most of the rollout

should be complete in 2003.

Wireless Internet services are still a bit disappointing. Sprint and Verizon have some of the most interesting offerings, but even from them what you get is pretty simple and only marginally useful. I like using mobile Web services for quick access to restaurant reviews from Zagat Survey LLC and Fodor's LLC and to get news clips if I'm traveling someplace where I can't get a newspaper. You also can get stock

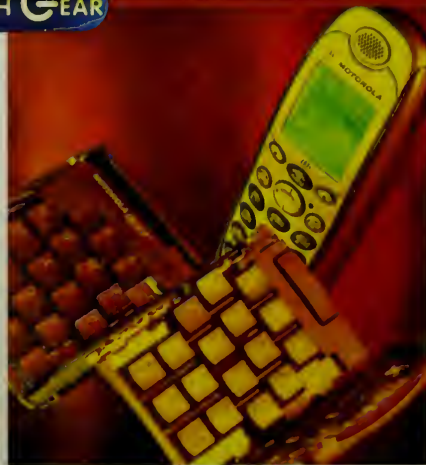
quotes, sports scores, weather horoscopes, and travel information. But you have to determine and incredibly patient. Typically, it takes 10 to 15 clicks to get anything useful—and Net connections on your mobile phone are just as unreliable as voice calls, so you regularly get cut off.

UPGRADES. Never fear, though—mobile Internet services are going to get better next year. In November, VoiceStream Wireless Company plans to introduce high-speed data services around the country, and other carriers have bumped up their data speeds in certain markets. Just as important, the phones and software are being refined so customers can get more useful information from the Net more easily. Motorola Inc., in particular, has been rolling out good phones that take advantage of the high data speeds. "Motorola is clearly No.1 in high-speed data phones right now," says Robert R. Stapleton, president of VoiceStream, based in Bellevue, Wash.

If you're looking for a mobile phone today, seek out the wireless carrier offering the voice plan that best suits your needs. But if you're after really good wireless Internet services, you may want to wait a year or two.

*By Peter Elstrom
New York*

FRESH GEAR



IBOARD

Motorola

idenstore.com

\$100

Jealous of that person next to you pecking away on the fold-up keyboard attached to their Palm while you're struggling to compose an e-mail on your cell phone's 10-key pad? Well, Motorola has teamed up with keyboard maker Think Outside to simplify text entry on the iDen phones it makes for Nextel and others. The keyboard is hit or miss for Web browsing, but it's just the ticket for typing short messages. When you're finished, it folds accordion-like to the size of a small paperback book.



**WORLD LEADERS. ROYAL FAMILIES. POP STARS. THE POPE.
(OUR DEMOGRAPHIC.)**



For over half a century, Land Rovers have been transporting very important people to very important places. Peace summits. Coronations. Sold-out concert venues. And somewhere between Winston Churchill and the Pope, it occurred to us: If we're going to be carrying luminaries, shouldn't we lavish them in absolute comfort and style? And so we created our first Range Rover. Should you be so fortunate as to drive the 2002 4.6 HSE, you'll discover our initial goal has evolved nicely. With advances that include Electronic Air Suspension, a 460-watt, 12-speaker Harman Kardon sound system and leather and burlwood interior appointments, our latest Range Rover stands ready to impress. Precisely the effect it had on the editors of *Kiplinger's*, who rated the Range Rover 4.6 HSE first for safety among SUVs*. Now only one question remains: What history will you make in it?



RANGE ROVER

IT'S A PHONE, IT'S A HANDHELD, IT'S...

Both, actually. A new breed of hybrid gizmos will appeal to technophiles

I'm always bumping into important contacts at lunch when I don't have a business card to give them. "Do you have a Palm?" I'm often asked. "I'll beam my info to ya." I carry a cell phone, but my Palm organizer is usually sitting in the cradle next to my PC. See, I hate stuffing my pockets with gadgets.

Hold on to your handset, cell users. The world's wireless wizards are now making "smart" phones. These handhelds combine cellular technology with software that can keep your calendar, manage your contact list, let you jot notes, and zap e-mail. Since a new breed of these gadgets will arrive for the holidays, I test-drove five that are expected to line shelves this Christmas.

The hybrid gizmos have impressive features, but that's not enough to push them into the mainstream. Only 1.5 million people will buy smart phones worldwide this year, out of 410 million mobile

phones, says researcher International Data Corp.

Of the phones I tested, the Samsung took top prize. If you ask me, a smart phone not only has to do brainy things, it has to look good, too. At \$500, the silver Samsung SPH I300, available from Sprint PCS, is the sleekest combo phone out there. It's more like a Palm with a phone hidden inside. Instead of dialing on a keypad, you touch virtual buttons on the 2½-inch-long color screen. The sides sport buttons for one-touch on-off control and one-handed scrolling through the address book. The best feature, however, is also the worst. Samsung's technology allows voice dialing for fast, one-handed calling. Just record, then speak a name into the phone. It worked from my office, but from the platform of the El train in Chicago, my Samsung phone turned dumb. It took four tries before it recognized the number I wanted.

The Palm-based Kyocera QCP 6035, available from Sprint and Verizon, offers similar functions. It's just not as attractive. A bulky, dull-gray thing that costs \$429, it looks more like a spotted stone than a cell phone.

FASHION STATEMENT. If making calls is your primary need, the Ericsson R380 World is your power tool. Available for \$500, its cellular technology works on the VoiceStream Wireless network in the U.S. and Europe. The buttons on the dial pad are easy to find and press. Rather than Palm software, the Ericsson's calendar, phone list, and other applications are based on less intuitive software made by Symbian. Flip open the keypad, and this compact unit reveals a surprisingly large, 3½-inch horizontal screen. (You turn the phone sideways to read it.) The drawback? Memory is a mere 1.2 megabytes, far less than the 8 MB most Palms boast for business users.

For a completely different look, there's the Motorola Accompli 009. Its compact design—as elegant as a Don Karan suit—is so cool, I clipped it to my belt simply for the fashion statement. Like the Ericsson, it's wired for use in Europe and the States. But it's really not a phone so much as a fancy \$550 text pager with voice capability tossed in. To take you plug in earphone speakerphone accessories. could never be my main phone. When I placed calls outdoors using the earphone, I couldn't hear anything but city buses whizzing by.

My least favorite is the VisorPhone from Handspring Inc. It's a Palm clone with a phone stuck on it. The phone module slips into a slot at the top of Visor Prism Platinum models. While they are terrific pocket PCs, the slip-in cellular antenna makes for an awkward phone. Handspring is your vendor of choice, wait until early 2001 when it will introduce the Treo—no snap-ons necessary. All these gizmos have nice features, but for my money they're not smart enough yet.

By Roger O. Crockett
Chicago

CELL PHONES GET SMARTER

They're not cheap, but these all-in-one devices can make life easier

PHONE	PRICE	SIZE	THE SKINNY
◀ SAMSUNG SPH I300 samsung.com	\$499	4.9 x 2.3" / 6 oz.	Screen will stick to your cheek—still, it's the slickest of the bunch.
ERICSSON R380 WORLD ericsson.com	\$499	5.1 x 2" / 5.8 oz.	Low on memory, but clever design gives it a sleek look.
◀ MOTOROLA ACCOMPLI 009 motorola.com	\$550	3.8 x 2.8" / 5.7 oz.	Clamshell mini-typewriter design makes typing cumbersome.
KYOCERA QCP 6035 kyocera.com	\$429	5.6 x 2.5" / 7.3 oz.	Bulky but functional. Get up to \$80 off if you buy the device from service provider Sprint PCS.
HANDSPRING VISORPHONE handspring.com	\$299	6.0 x 3.0" / 9.8 oz	Nice try, but it looks too much like a geeky Pocket PC and too little like a cool phone.

Data: Company Reports, BusinessWeek



Software quality ↑ 80%

Developer productivity ↑ 300%

ROI ↑ 1400%

Testing time ↓ 95%

Development cycle ↓ 66%

Lump in throat ↓ 100%



Lies, damn lies and statistics, you say? Some of our customers used to be cynical, too. Before they were customers. But then they started sending us these numbers. Telling us that the results of using our best practices, integrated tools and services exceeded their expectations. Cutting test time, decreasing development cycles and reducing bugs. Freeing their teams from the obstacles that hinder software development. Need more evidence? There's plenty available at www.rational.com/customersuccess4.

be liberated



WHICH ONE SHOULD YOU STICK IN YOUR EAR?

Cell-phone headphones vary widely in comfort, sound quality, and price

It's nearly 1 p.m., and I'm late for my power lunch.

Traffic is snaking through the streets of Beverly Hills, and I'm frantically working the stick shift of my aging BMW while juggling my Nokia cell phone. The two Hollywood agents I'm meeting are no doubt already shuffling into Wolfgang Puck's new and improved Spago. I'm on my way, I tell the woman answering Spago's phone—don't let them give away our table to Denzel or J.Lo.

My ride to Beverly Hills makes me an accident waiting to happen, a commercial for a hands-free accessory—specifically, one of those earpieces you see dangling from folks at Starbucks who look like so many fools talking into their lattes. Perhaps those people are simply being safe, especially if they intend to jump into their own Beemers.

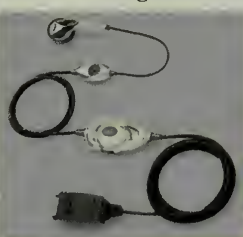
Many local governments as well as some European countries already ban holding a cell phone while driving. Several states also are contemplating bans. Starting on Nov. 1, New York State will

allow drivers to talk only while using speakerphones, "earbuds," or some other hands-free gadget. It's a

tough sell for most people, Hollywood moguls or no. But try arguing the point with supermodel Niki Taylor, who only recently recovered from injuries she suffered in a car accident in May when a friend fumbled with his cell phone while driving.

I'm a believer now. After a couple of weeks of trying out a variety of ways to keep my hands on the wheel, I see the payoff in better driving—and more interruption-free conversations. Choosing the right gizmo to free your hands, however, depends on how long you can take having something sticking in your ear. If you can't stand it at all, you might try the \$22 Plantronics M130, an over-the-ear headset that rests a soft pad against your ear. Its boom mike is great, but it's

not my top pick. Like most ear sets that aren't anchored in the ear, it sometimes jiggles free in mid-conversation.



My favorite is another Plantronics design, the \$19 M206-N2. It's an earbud—the in-the-

ear type—that comes with felt covering to ease the pain. Its best feature is an on-button that dangles mid-stick on the wire that runs through the phone. The on-off switch keeps you from fumbling with your phone to answer calls. Other models come with on-off switches, but the M206-N2 is one of the few that also has volume control, a great help in drowning out street noise.

Getting the right fit is key, even if you're not a power player who's addicted to your phone. I tried the \$25 Jabra EarBoom, named for a tiny boom mike that sticks out about cheek level. The sound quality is better than on the Plantronics models. The problem is comfort. Jabra's ear sets come with colorful plastic inserts to fit small, medium, and large ears, yet I couldn't find one that was comfortable for long periods of time. Neither could my 17-year-old daughter.

Another Jabra model, the \$40 EarSet, mounts the boom mike in the earpiece itself instead of at the end of the boom or on the cord. It's a clever idea, and it works just fine. But beware: If you adjust the earpiece for comfort, the person on the other

SAFER IN THE FAST LANE

Accessories for your cell phone

COMPANY/MODEL	PRICE	THE SKINNY
▲ PLANTRONICS M206-N2 Earbud plantronics.com	\$19	Good sound and fits easily in ear. Volume control is a big plus for drowning out traffic noise.
JABRA EarBoom jabra.com	25	Great-sounding mike, but comfort can be hit or miss despite variety of earpieces included.
RADIOSHACK Handsfree Speakerphone radioshack.com	60	Sound fills the car, but the speakerphone mike is weak. Cigarette-lighter mount can get in the way of stick shifts.
MOTOROLA Bluetooth Wireless Headset motorola.com	149*	Wireless earpiece/mike approach is cool. A plastic wire wraps around the ear to hold it in place. Its performance is spotty, and pricey to boot.

*Requires Bluetooth phone such as Motorola Timeport 270c phone, \$399

Data: BusinessWeek, companies

may yelp in pain from noise.

The downside of earpieces and headsets is that your ear can soon fill up with wires. You might try a speakerphone instead. Radio Shack Corp. makes a \$60 speakerphone that plugs into a cigarette lighter and connects to the phone with a cord. The speakerphone comes with a clip to pin the microphone on your visor. I found the speaker a little weak even when I held it in front of my face. You don't want to try some of the newer cell phones that come with built-in speakerphones. They work as well, if not better.

DISCREET OFF. In my movietown days, Bluetooth phones are a big buzz. So I tried one. Motorola Inc. will soon be selling a wireless Bluetooth earbud that communicates over a radio link to a Bluetooth phone. (I used Motorola's Timeport 760c.) A good idea, but it still needs work. It's light, yet curiously heavy, and the over-the-ear design doesn't always stay in place when you move your head. The microphone quality was spotty, too—listeners said it was like I was talking through a tunnel. And its cost is outrageous: At \$149, I'd wait for the price to drop and quality to improve.

The best price I found for the earbud was free (plus \$5 shipping) at www.your-ular.com, a retail site for phone batteries and other accessories launched by Jeff Zar, a 23-year-old entrepreneur-turned-safety-advocate after his own near-miss accident while on his cell phone. AT&T Wireless also offers a free, stripped-down earbud to new and existing customers. That's great public policy—and good business. I never calls from my Beemer have increased my phone bill 10% since I started talking hands-free.

By Ronald Grover in Beverly Hills, Calif.

PHONES YOU CAN USE AND THEN LOSE

Ultracheap, prepaid disposable cell phones hit the shelves this fall

Just how cheap and ubiquitous can cell phones get? If a trio of upstart companies has its way, cheap enough to throw away when you're done. Move over, Pampers: Here comes the disposable cell phone.

Throwaway phones have been talked about since New Jersey entrepreneur Randy Altschul, creator of Barbie's 30th Birthday Game, patented a device made mostly of paper in 1999. The idea is that disposables—rock-bottom-cheap phones with a certain number of minutes' worth of calling programmed in—will be an alternative to calling cards, prepaid wireless plans, and pay phones. And at \$30 or less, they can be cheaper than a conventional mobile phone while more convenient than a calling card.

These phones have sold well in Japan. Now, three U.S. companies are about to offer them here. Hop-On Communications in Garden Grove, Calif., is first out this fall with a \$29.95 phone with 60 minutes of talk time included. Altschul's Cliffside Park (N.J.)-based Dieceland Technologies expects to ship early next year, but exact dates and pricing are not certain. She says they'll cost \$10 to \$30, depending on how many minutes you get. Both companies plan to team with a variety of service providers. Hop-On's first partner is Cingular. San

Francisco's Telespree Communications is testing a semi-disposable phone. You keep the phone but replace a battery attachment that also manages your minutes.

CHARGES. Are disposable phones a good deal? There's no doubt the 50¢-a-minute tab for Hop-On's phone is pricier than 60-

ample, charges prepaid users up to 35¢ a minute, plus \$125 for a phone and activation. So an infrequent user might go disposable.

Do the disposables work? From Dieceland's headquarters—a.k.a. Altschul's driveway—I called my editor in New York and my home in another part of New Jersey.

People at the other end heard me clearly. At my end, there was a slight echo in the earbud/microphone that plugs into the phone. The push-button dialing worked without a hitch. Instead of a dialpad, Hop-On's phone (like Telespree's) uses voice recognition software that makes you say the number you want to call. This phone couldn't seem to find outgoing lines in the office-building canyon where I work. But I was able to make calls in New Jersey. Telespree wouldn't provide a prototype.

Dieceland's phone is a radical design, with metallic ink on the paper substituting for wires. Hop-On's phone is a plastic rectangle, about half an inch thick

and a little longer than a credit card. The battery and software to manage your minutes are inside the case. In Dieceland's phone, they're in an attachment.

The technology works in optimum conditions. Now we'll see if consumers buy it.

By Timothy J. Mullaney in Cliffside Park, N.J.



DIALING IN *The companies' idea is to offer an alternative to prepaid wireless plans, calling cards, and pay phones*

minute calling cards, which vary widely in price. AT&T, for instance, charges 16¢ to 22¢ a minute, and tacks on a surcharge if you use a pay phone. But a calling card itself can't connect you—you have to find a phone. Disposables are cheaper than many prepaid mobile-phone plans. Verizon Wireless Inc., for ex-



LAPTOPS OF LUXURY

They're cheaper and more powerful than ever

The era of the Road Warrior may have been supplanted by that of the Road Worrier in the wake of September 11. But that doesn't mean laptop and notebook computer users are becoming shut-ins. Buyers, from hot-shot executives to cost-conscious students, are continuing to snap up mobile machines even as the desktop business slows to a crawl. In fact, there has probably never been a bet-

time to buy a computer that has plenty of power and is ready to travel. "All the major PC makers are cutting prices and sacrificing mar-

Promises of market researcher IDC. "They want your business right now."

And they're proving it with bargains. These days a notebook computer with 128 megabytes of random access memory, a reasonably fast processor from Intel or Advanced Micro Devices, and a 10-gigabyte hard drive can be had for as little as \$1,000. Those willing to open their wallets much wider can get a

notebook that performs nearly as well as any muscle-bound desktop machine. Hewlett-Packard's OmniBook 6100, for example, will set you back \$3,700, but its 1.13 GHz Mobile Pentium processor, 256 MB of RAM, and 30-GB hard drive won't slow you down as you calculate which stocks you should sell to pay for it. At any price point, laptops today will run Microsoft's new Windows XP operating system,

but you should get at least 256 MB of memory. Most will come with XP pre-loaded.

There's more good news: The price gap with desktops is narrowing. Sure, a portable costs more than a similarly configured desktop—hey, you pay a premium for mobility. But instead of a gap the size of the Grand Canyon, it's more like the width of the Mississippi. Two years ago, the average price of notebooks was \$900 higher than that of desktop PCs, according to IDC. Now, the difference is \$600.

Today, power user no longer means power hog. In the past year, both Intel and AMD have introduced processors that sip electricity and can extend the battery life of



COMPAQ EVO N600C

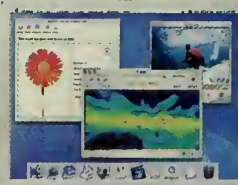
LAPTOPS: POWER AND PORTABILITY

BusinessWeek asked analysts in TechTV's testing lab to sort through portable computers to find the machines that give the best performance for the price. Here, in order of preference, are their picks.

SPECIFICATIONS	DIMENSIONS W X D X H (INCHES)	WEIGHT (POUNDS)	PRICE	THE SKINNY	
DESKTOP REPLACEMENT					
DELL LATITUDE 6110 dell.com	Mobile Intel Pentium III-M 1.13 GHz; 256 MB; 48 GB	13.0 x 10.9 x 1.8	7.7	\$3,284	Loads of power and features galore: Big screen, hefty hard drive, and built-in wireless all packaged with blazing performance.
HP OMNIBOOK 6100 hp.com	Mobile Intel Pentium III-M 1.13 GHz; 256 MB; 30 GB	12.8 x 10.4 x 1.4	6.2	\$3,791	The lightest of the desktop replacement models packs plenty of power. One downer is the price. You're paying plenty to shave an extra pound or two off your shoulder.
DELL LATITUDE 6150 dell.com	Mobile Intel Pentium III-M 1.13 GHz; 256 MB; 30 GB	13.3 x 11.3 x 1.7	8.0	\$2,628	It's heavy, but take a look at that huge 15.7-inch display and expansive hard drive. It packs lots of power for the price.
MOBILE WORKHORSE					
COMPAQ EVO N600C compaq.com	Mobile Intel Pentium III-M 1.06 GHz; 256 MB; 20 GB	12.1 x 9.8 x 1.2	5.5	\$2,394	Light and powerful, with battery life pushing four hours. A great companion for a traveling exec who doesn't want to skimp on performance.
DELL LATITUDE 6110 dell.com	Mobile Intel Pentium III-M 1.2 GHz; 256 MB; 10 GB	12.5 x 9.9 x 1.4	5.8	\$2,508	Excellent bang for the buck and the best graphics capabilities of any mobile workhorse. Integrated wireless keeps you connected on the road.
HP OMNIBOOK X1 hp.com	Mobile Intel Pentium III 1.0 GHz; 320 MB; 20 GB	11.6 x 9.4 x 1.1	5.2	\$2,199	At 5.2 lb., the X1 is easy on the shoulder. It also has loads of RAM standard and a DVD/CD-ROM combo drive. An excellent value.

a computer by 10% to 20%. Machines with the weakest battery life today can run for better than two hours, while those sporting slots where users can load an extra battery can top five hours.

That extended battery life has helped Larry Argabright make more of his frequent train trips. Argabright, a transportation planner for Amtrak, pops his Hewlett-Packard OmniBook 500 in his briefcase when he hops a train from his office in Philadelphia



APPLE iBOOK

to the railroad's headquarters in Washington. The battery "lasts all the way to Washington and back," more than three hours round-trip, Argabright says. "It's unbelievable." While the smallish keyboard took some time to master, Argabright says that's a small price to pay for the portability of the 3.5-lb. machine. Costing about \$3,000, the HP isn't cheap, but for the money you'll get a relatively speedy 750 MHz Mobile Pentium chip, 256 MB of RAM, a 12.1-in. screen, and a roomy 30-GB hard drive. For Argabright, it's plenty powerful to handle the financial modeling and transportation planning he does on his trips.

You don't always have to

pay a lot for an ultra-lightweight laptop. Tim Grissel Jr., president of Newell Machinery Co. in Hiawatha, Iowa, takes his 3-lb. Gateway Solo 3450 home with him most evenings to finish up work for Newell, which installs machinery in grain-processing plants. He likes the computer's diminutive size—it's less than an inch thick—better than an older Gateway he used that weighed in at nearly 10 lb. "I didn't really want to carry [the older machine] anywhere, so I found myself leaving it in one place," Grissel says. Starting at less than \$2,000, the 3450 is among the least expensive flyweight machines, and features a 750-MHz Mobile Pentium chip,

192 MB of RAM, a 20-GB hard drive, and a 12.1-in. screen.

And now, ultra-portable longer means ultra-flimsy. Hall found Compaq's flyweight Evo N400c tough enough subject it to the hammer hands of schoolkids. As information technology director for the Kent School District, south of Seattle, Hall has bought 1,000 of the 1.5-lb. machines and expects to pony up for another 3,000.

The district is buying the tops for mobile computing that bring the machines to students in their classrooms. "The durability of the Compaq model is what appealed to us. And the light weight makes them easier for kids to handle," Hall says.

EASY ON THE SHOULDER—AND THE WALLET

If you're willing to pay top dollar, you can snap up a machine that weighs less than a fly. But there are a couple of feature-packed bargains, too.

SPECIFICATIONS		DIMENSIONS W X D X H (INCHES)	WEIGHT (POUNDS)	PRICE	THE SKINNY
ULTRALIGHT					
IBM THINKPAD X22 ibm.com	Mobile Intel Low Voltage Pentium III-M 800MHz; 256MB; 20GB	11.0 x 8.9 x 1.2	3.7	\$3,157	It weighs a bit more than other ultralights, but the X22 runs most programs up to 20% faster than rivals. And it has nearly four hours of battery life and the best graphics in its class.
HP OMNIBOOK 500 hp.com	Mobile Intel Low-Voltage Pentium III 750 MHz; 256 MB; 30 GB	11.0 x 8.7 x 1.0	3.5	\$3,049	A take-it-anywhere PC. And with the best docking station we've reviewed, the 500 is a snap to use at home, too. Keyboard is a bit cramped, but should work for all but the chubbiest fingers.
COMPAQ EVO N400C compaq.com	Mobile Intel Low Voltage Pentium III 700 MHz; 256 MB; 20 GB	10.0 x 8.9 x 0.9	3.5	\$2,632	Super-versatile, with a fullsize keyboard that touch-typists will love. The downside is its brief, 2.5-hour battery life.
GATEWAY SOLO 3450 gateway.com	Mobile Intel Low Voltage Pentium III 750 MHz; 192 MB; 20 GB	10.7 x 8.9 x 1.0	3.0	\$1,999	The Solo 3450 is extra easy on the shoulder. And at less than \$2,000, it's easy on the budget as well.
VALUE					
SONY VAIO SR33 sony.com	Intel Celeron 600 MHz; 128 MB; 10 GB	10.2 x 8.2 x 1.2	3.0	\$1,000	You compromise a bit on performance but this Vaio is cheap and light. It also has a slot for MemorySticks for quick loading photos from a Sony digital camera onto a PC.
APPLE iBOOK apple.com	PowerPC G3 500 MHz; 128 MB; 15 GB	11.2 x 9.1 x 1.4	4.9	\$1,299	Apple comes up with a machine that's competitive with Windows PCs in price and performance. Add Apple's nifty industrial design and you've got a winner.



SAVING POWER: Argabright prizes the OmniBook 500's battery life

ile Hall gets a price break buying in quantity, the 00c costs about \$2,600 with 700-MHz Mobile Pentium processor, 256 MB of RAM, a GB hard drive, and a dock-station.

No matter how tough laptops get, not everyone wants make the sacrifices necessary to cram a computer into 3-lb. box. The tradeoffs in therweights are in screen e—most top out at 12.1—and optical drives.

Manufacturers haven't figured out how to fit CD-ROM or DVD drive to a machine that light. But you're getting closer. Most PC makers now build mobile workhorse computers weighing roughly 5 lb. that offer a larger screen—up to about 14—and swappable optical and floppy drives. The star of this group is Compaq's 5.5-lb. Evo 100c. For about \$2,400 you'll get a 1.06-GHz Mobile Pentium processor, a 30-GB hard drive, and a 14.1-in. screen. For added flexibility, users can pop out the CD-ROM and snap a DVD or floppy drive when

needed. Best of all, the N600's battery will keep chugging for almost four hours. If you're on a budget, Winbook offers a similarly configured machine, its 5.2-lb. X1, with a generous 320 MB of RAM for less than \$2,200.

Some users crave the full desktop experience even when they're on the road—and weight is no object. Take MJ Kelli, a radio host at WFLZ in Tampa, Fla. He bought a Gateway Solo 9550

this fall to take with him to the studio where he tapes his morning talk show. He uses the 8-lb. machine to download sound effects and burn CDs to use on the air. And he spends several hours a day surfing the Web to research topics and guests for his show. At home, Kelli edits videos on the machine's ultra-roomy 15.7-in. screen. One key advantage of the 9550 is its connectivity, he says. The \$2,600 computer has five different slots where printers, modems, and video cameras can be plugged in. "I can almost hook the garden hose up to this thing and water the plants," Kelli jokes.

For the would-be Oliver Stone without the movie studio budget, there are plenty of inexpensive notebooks on the market. Debra Mattos likes to edit videos on her computer, too—but does it for a lot less money. The third-grade teacher in Ponte Vedra Beach, Fla., used her 4.9-lb. Apple iBook fitted with 256 MB of RAM and a 500-MHz G3 processor to make films and CD photo albums of her sister's wedding last summer. In

class, she creates video and still presentations with the computer, which starts at \$1,299. Her students use similar machines—all linked via a wireless connection—to chat online with researchers studying wildlife in the Amazon and to do assignments for class. "It's really a motivational tool," Mattos says.

Cheaper still is Sony's Vaio SR33. This \$1,000 machine is as light as they come—just 3 lb. The computer has a relatively slow 600 MHz Celeron processor from Intel but makes transferring photos and video a snap with its MemoryStick slot and a firewire connector—which offers a high-speed link to video cameras. The main drawbacks are its small keyboard and its skimpy, 10.4-inch screen. If you're willing to shell out a little more money, at the high end of the budget segment is Compaq's Presario 700. For about \$1,200, you'll get a 14.1-in. screen, a 900-MHz AMD Athlon 4 processor, and a 20-GB hard drive—but the machine weighs a hefty 6.5 lb.

With so many choices at reasonable prices, there's plenty of life left in the laptop. Granted, there's little a computer can do to assuage the new angst. But once you get the right model for your needs, at least you'll have one less thing to worry about.

*By David Rocks
in New York*

FRESH GEAR



BACK OFFICE

Shaun Jackson Design

sjdesign.com

\$140

At last, a backpack version of Shaun Jackson's award-winning Lapdog, a computer case that unfolds on your lap to create an instant office. It has the same fold-out side pockets for cables and drives, and a new side zipper so that you can slip the computer out without opening the case, easing trips through airport security. The padded shoulder straps stow in their own pocket in the rear should you want to use it as a single-strap vertical briefcase.

DESKTOP POWER FOR A PITTANCE

PCs that can handle XP can be had for a song

Not so many years ago, buying a PC was like buying a car. Consumers obsessed for months over geeky technical specifications as if they were choosing between a basic Chevy and a souped-up Ferrari.

Now, buying a PC is no more complicated than buying a TV. And it's often cheaper. Just ask Rick Wilbins. The Dallas communications consultant bought a PC in just 15 minutes, paying \$700 for a Compaq Presario with a monitor and a printer—half what he spent on his last computer. “I don’t need all the knobs and buttons to make me feel good,” says Wilbins. “And I certainly don’t want to pay for them.”

MORE FOR LESS. There's little chance of that these days. Sales-starved PC makers are slashing prices and throwing in free shipping, memory, and more. And if price isn't enough of an incentive, there's Microsoft's Windows XP, the first consumer version since Windows 95 that's worth going to the stores for. It's far less crash-prone, and it's designed to help even novice PC

users master tasks such as digital photography.

What should you buy? Let's start in the bargain bin. Microsoft says you'll need a 300-megahertz processor and 128 megabytes of random-access memory to handle Windows XP. The processor isn't a problem since it's tough to find a machine that runs slower than 900 MHz. But you'll want at least 256 MB of RAM and a 20-gigabyte hard drive to smoothly surf the Net, run programs such as Quicken, and play most games. Compaq's Presario 5300 meets these basic specs and goes for just \$569 without a monitor.

To really tap XP's improved handling of digital photos and online music, you'll have to spend a bit more. XP makes recording CDs or downloading songs off the Net a snap. But you'll want plenty of hard-disk space to store this digital fare, as well as a rewriteable CD drive to burn disks for the car or your stereo. Plenty of models fit the bill, priced from \$800 to \$1,300. A good bet: Dell's Dimension 4300, which comes



CLOUT: Personal trainer Pfeufer haggled with Gateway

with a 1.6-gigahertz Pentium 4 chip and a 40-GB hard drive for \$959.

Would-be moviemakers might end up spending a bit more still. To fulfill your Spielbergesque ambitions, look for plenty of storage and a Firewire connection. A standard feature on most digital video cameras and MP3 players, Firewire speeds downloading clips or tunes. Apple's iMac, ranging from \$799 to \$1,499, is still tops for ease of use. And Sony's \$2,799 Vaio MX comes with a 1.7-GHz Pentium 4 chip, an 80-GB hard

drive, and a rewriteable DVD drive to store your flicks.

It's a buyer's market. When a Gateway rep told Brian Pfeufer that shipping for a \$650 PC would be \$90, Pfeufer joked: “What, are you wearing a mask and holding a gun?” The shipping fell to \$45—and Gateway threw free home-design software well. “I got a good deal,” the New York personal trainer says. And he didn't have to obsess for months to find it.

By Andrew Pan
in Dallas

WHICH WINDOWS XP PC IS FOR YOU?

Microsoft says any PC with a 300-MHz chip and 128 MB of memory can run Windows XP. But you'll probably want more. Here are three good bets, depending on your needs:

IF YOU WANT...	MODEL/COMPANY	SPECS	PRICE	THE SKINNY
AN XP STARTER BOX	Presario 5300 Compaq compaq.com	1.1-GHz Intel Celeron chip, 256 MB of memory, 20 GB of storage, CD-ROM drive	\$569	More than enough power for basic Web surfing, game playing, and such. Sold only in stores.
A MID-RANGE CHOICE	Dimension 4300 Dell dell.com	1.6-GHz Intel P4 chip, 40 GB of storage, DVD, and recordable CD-ROM drives	959	Good choice if you plan to explore XP's digital photography and online music features.
TO MAKE THE MOST OF XP	Pavilion 7965 Hewlett-Packard hp.com	1.7-GHz P4 chip, 512 MB of memory, 80 GB of storage, high-speed Firewire connections	1249	Has what it takes for making home movies or other complex multimedia projects.

Data: BusinessWeek, Company Reports, ARS Inc.



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The latest flat-screen displays are sexy—and a lot cheaper

For more than two years, only the commodity traders at energy provider Mirant Corp. got flat-panel displays. All the while, the rest of Mirant's employees were begging to have the sleek set-ups on their desks, too, in place of the usual company-issued boxy monitors. "We fought it for a while," says Don Roxby, a support analyst at Mirant. But when prices dropped below \$500, Roxby started buying flat panels in earnest. Mirant now has around 500 of them in its Atlanta office, and the rest of the employees no longer feel like the forgotten have-nots.

Neither should you. Top-quality, 15-inch liquid-crystal monitors now go for around \$400 and can drop below \$300 if you're willing to settle for an off-brand and play the rebate game right. That's not much more than the usual pot-bellied glass tube monitor would have cost you a few years ago. Bigger models are still plenty pricey, though, with 17-inch displays starting at around \$800 and 21-inch models going for well over \$2,000.

BEFORE YOU BUY. Shop carefully. The display is where you come eye-to-eye with your computer system, and you want to make sure you're comfortable with such idiosyncrasies as brightness, color, and viewing angle. It's all pretty subjective, which means that you should shop in person rather than depend on descriptions in a catalog or on a Web page.

If you're the type, for example, that attracts crowds around your desk to see your latest, um, spreadsheet, you want to make sure that the screen looks as clear and

bright to the folks standing over your shoulder or off to one side as it does to you. Another feature to look for is whether or not the screen

can pivot around to the vertical position, handy for working on letter-size documents and for Web surfing. Some models have it, some don't.



SAMSUNG SYNCMASTER 570V

Among the 15-inch flat displays, the Samsung SyncMaster 570V looks to be the best bet. It has no visible flicker, which makes for less eye fatigue when you're camped in front of your computer for long periods of time. At \$400, it's reasonably priced, and it comes with a three-year warranty, better than most. A good

second choice is the Philips MultiSync LCD1530V, at \$400. It's a little more compact than the Samsung, but has a nice auto-adjust feature that saves you a more step when you get home and set it up.

If you want something a bit bigger, go with Philips 170B, a 17-inch monitor that's very competitively priced at \$750. It's the sharpest and brightest of the bunch, with especially lively colors. It's the best pick, especially if you view a lot of photographs or play PC games. Or take a look at the Acer FP 751. The colors are slightly more muted than those on the Philips display, but there's little flicker, and the text and graphics have nice, clear quality to them.

Once you get your flat-panel home and out of the box, you'll notice a difference on your desktop immediately. The depth of a typical 15-

PICKS OF THE PACK IN FLAT-PANEL DISPLAYS

Evaluators at TechTV's testing labs have identified these displays as the best buys for the money. The list is in order of preference by size

COMPANY/MODEL	PRICE	WEIGHT	THE SKINNY
15-INCH MONITORS			
▲ SAMSUNG SYNCMASTER 570V samsungmonitor.com	\$400	12.6 lb	Competitively priced display has sharp text and graphics and a three-year warranty on backlight
NEC MULTISYNC LCD1530V necmitsubishi.com	400	14.8	An alternate choice with solid text and graphics, easy screen controls, and same three-year warranty on backlight
17-INCH MONITORS			
PHILIPS 170B philips.com	750	17.6	A bit taller than most, the Philips model has realistic colors and easy-to-use swivel but is difficult to set up
ACER FP 751 acercm.com	780	17	Monitor has vibrant colors and flexible tilt and swivel, but built-in speakers are subpar
21-INCH AND UP MONITORS			
APPLE CINEMA DISPLAY apple.com	2,500	25	It's only compatible with the Apple G4 and doesn't swivel, but super-slim display has razor-sharp text and sumptuous colors
NEC MULTISYNC LCD2110 necmitsubishi.com	4,000	32	Very expensive model has easy tilt and swivel, adjustable height, sharp text and graphics

Data: TechTV

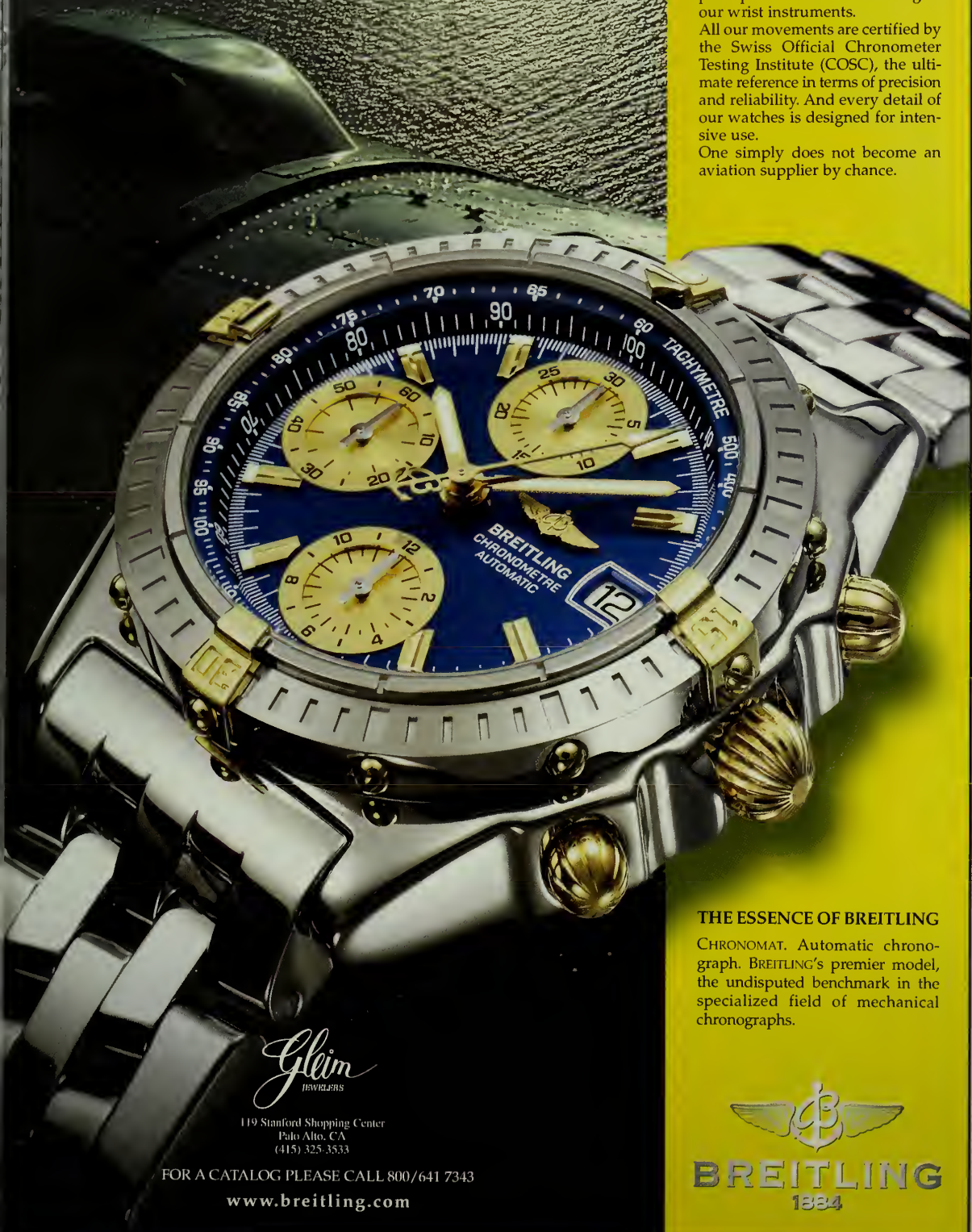
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Nasdaq Disaster Relief Fund

NASDAQ

panel monitor is around 6 inches if you count the monitor's base. It's a huge advantage over 16 inches normally taken between the keyboard and wall. Not only does a flat screen free up more desk space for the rest of your computer, it's lighter and easier to move around than a CRT. It's also a lot sexier.

AST START. Setting up a flat-panel display is a snap. Unlike early LCD screens, where you often had to open up your computer to install a new graphics card, these are plug-and-play. Just hook up the cable and turn on your computer. If you want to adjust the monitor's brightness, position, color settings, you need to run a small program that comes with the display. That's probably a good idea. Most flat-panel displays come with brightness turned almost the way up. It's a merchandising trick: Every manufac-

SHARPER Prices climb for flat panels over 15 inches. But for crisp images, a 21-inch is the only slim option

turer wants its display to seem the brightest of the long line of displays sitting side-by-side on the showroom floor.

Once you've got every-



APPLE CINEMA DISPLAY

thing adjusted to comfortable levels, you'll start to notice the difference in picture quality, something you may have missed in the store. The images are not as sharp and the colors are not as deep and vibrant as on a CRT display. For most people, that's a small price to pay for the real estate gain and the cool factor. But if you're a graphic artist or digital photographer, that's enough to make you pass on flat-panel displays, the small ones at least. On the smaller screens, the colors aren't true enough, and the images will have jagged edges.

Of course you can splurge for a high-end, 21-inch or bigger flat screen, but at what price? The Apple Cinema Display is a stunner, the

Mona Lisa of computer displays, but will set you back \$2,500 for the 22-inch screen. For PC users, the 21-inch NEC MultiSync LCD2110 is nearly as good. It's a cool four grand.

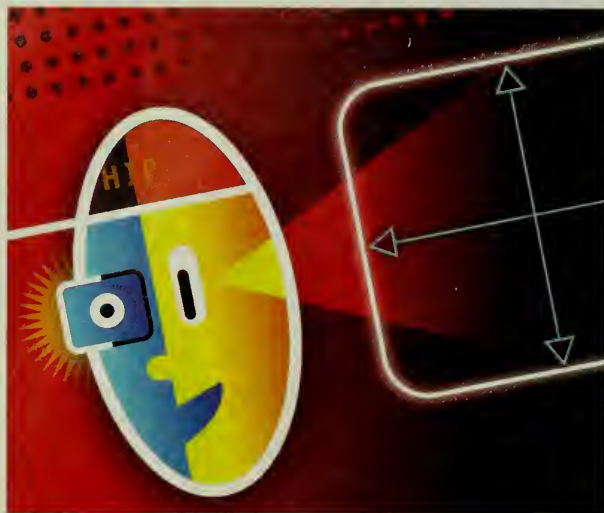
That's not necessary for the majority of buyers, who deal mostly with word processing, spreadsheet, and database programs. Any of the newer, flat-screen displays can easily handle the images that most people run across on Web pages, say, or digital snaps e-mailed by friends. Today's bargain prices should be incentive enough to pick up a new slim-and-trim flat panel for your system. Your desk will thank you for it.

By Darnell Little
in Chicago

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COOL SPECS FOR THE TECH SET

But cybervisors aren't worth the high price yet

The six-hour flight from San Francisco to Montreal takes off without a hitch. The plane is packed with people reading newspapers or doing paperwork. The scene is what you would expect, except for the guy crammed into seat 24B. He has a laptop computer open and he's wearing an eyeglass contraption that makes him look like a character out of the *X-Men* comics.

That person is me. The high-tech goggles I have on are the latest in wearable computer monitors, the Cy-Visor DH-4400VP display system, made by a South Korean company called Daeyang E&C and marketed in the U.S. by Personal Display Systems Inc. of Sacramento. Immediately, my neighbors take notice. A triumphant inner voice tells me I'm the coolest kid on the block—or the geekiest.

To while away the flight, I decide to check out whether monitors like the Cy-Visor have more than gee-whiz appeal. These devices work

through common video and audio connections, essentially transferring images from a computer, DVD player, VCR, or game console to tiny flat-panel screens situated in front of one or both eyes. The screens fit into an eyeglass-shaped casing and give

the feel of viewing a big-screen television at six feet.

The 4-ounce Cy-Visor I'm wearing has reflective silver lenses attached to a cushiony headband with tiny speakers for my ears. Right away, I learn two important lessons: The Cy-Visor needs to be attached to a control box to display games or e-mail. It also needs batteries, which I didn't bring along. You either plug these units into an electrical outlet or shell out \$70 for a 90-minute battery pack—and the chance to be truly mobile. I sink back into my seat, bored for the next four hours of my flight.

SQUIGGLY LINES. Days later, I'm sitting in my office ready to take another crack. The \$999 Cy-Visor again gives me trouble. I've hooked the wires to the appropriate connections, called up an on-screen menu, selected the PC option, and been rewarded with a bunch of squiggly lines. The problem: The unit cannot handle the XGA-type video format, which rules out many business notebooks. On my home computer, I have more success. Images from a video game are crisp, but when I switch to my e-mail, the picture goes dark and returns

only after I reboot and up another game.

Time to move on. I have better results with Olympus 4-oz. Eye-Trek model R700. This device comes with a hefty \$1,199 price tag and can be plugged into PCs, portable DVD players, and game consoles. But the Eye-Trek is comfortable. The molded, glass-shaped plastic is a size-fits-all, and I learn I'm not that size. Olympus' "super-optical resolution" does reward me with a Yahoo! news page, yet the words are blurry. I start up a PC game and get a clearer picture. Within 10 minutes my head feels like it's going to explode from the eye strain and uncomfortable fit. No wonder makers warn to limit use to two hours at a time.

For now, these gadgets aren't worth the price they deliver. A moderately priced \$1,200 notebook computer can play the same game at better resolution, display text clearly. Guess I'll keep the monitor on my desk and forget about looking cool.

By Cliff Edwards in San Mateo, Calif.



SONY GLASSTRON PLM-A3

THE LOWDOWN ON EYEGLOSS DISPLAYS

Here's the latest in eyeglass-style gear that essentially acts as a computer monitor. Plug the glasses into a PC or game console, and the view is like a large-screen monitor six feet away.

MODEL/MAKER	PRICE	THE SKINNY
EYE-TREK FMD-700 Olympus olympus-eye-trek.com	\$1,199	This Rolls-Royce model hooks into virtually any electronic device. Gamers will love it, but poor resolution makes reading spreadsheets and text a trial.
CY-VISOR DH-4400VP Personal Display Systems personaldisplays.com	999*	Boasts cool reflective silver lenses and a wraparound headband that's tops in comfort. Great for watching video and playing games, but reading text is painful.
EYE-TREK FMD-20P Olympus olympus-eye-trek.com	399	It's designed for Sony's PlayStation2 game console. Gamers would do better to shell out more bucks for a big-screen TV, since the suggested time for using the display is no more than two hours.
GLASSTRON PLM-A35 Sony sony.com	400	Discontinued this summer, the Glasstron is still sold on the Internet. If e-tailers heavily discount it for the holidays, the Sony unit could be an affordable way to sample the technology.

* Personal Displays says it's boosting the price of this model to \$1,299 on Nov. 1

Data: BusinessWeek, Company Reports


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BOND BUYING,
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Getting the Most Bang Out of Your Bonds

As with stocks, diversification can protect your portfolio

BY SUSAN SCHERREIK

Do you think bonds are frumpy? Well, consider this. Prices for short-term U.S. Treasuries surged 9.1% between January 1 and Oct. 29. Other top-notch bonds have done as well or better. Investment-grade corporates are up 11.2%, and insured municipal bonds returned 9.1% on a tax-adjusted basis for investors in the 35.5% tax bracket. That performance is particularly impressive in light of the Standard & Poor's 500-stock index's 18.3% decline during that time and the 31.2% meltdown in the Nasdaq.

Now that your interest in interest-bearing investments has been piqued, watch out. The bond market isn't as treacherous as the Nasdaq at 5,000, but it's becoming a lot less appealing. On the safest investments, you won't earn much interest. Aggressive monetary easing by the Federal Reserve—nine cuts since January—has helped to drive yields on short-term U.S. Treasury securities to their lowest levels in decades. And for long-term bonds, the bigger risk could be higher interest rates.

For many, the antidote for low short-

term yields is to invest in longer-term government bonds or even to buy corporates. But with bonds with the longest maturities yielding the most, they also lose the most in value when interest rates rise. How much? Jeffrey Kleintop, chief investment strategist at PNC Advisors in Philadelphia, uses this rule of thumb: For every

percentage point that interest rates rise, the price of a 30-year bond will fall nearly 13%, vs. 7% for a 10-year issue and 4% for a five-year issue.

Kleintop, for one, thinks rates will be moving up next year, and so suggests that investors in U.S. government bonds stick to issues maturing in five years or less.

Corporate bonds, both investment-grade and high-yield—or “junk” bonds—have had their problems. So far this year, according to S&P, companies have seen their credit ratings slashed, and junk-bond defaults are expected to re-



, the highest level since 1991. But if the economy strengthens next year, corporates are likely to fare better than Treasuries. Sure, there'll be some downward price pressure from rising rates, but a healthier economy also ports more bounteous cash flows and improved debt quality.

Take the same diversified approach to bonds you do with stocks. Blend in U.S. government, corporate—both high-quality and high-yield—and perhaps even foreign government bonds (page 152). If you're investing taxable dollars, consider tax-exempt muni bonds (page 155). It doesn't hurt to layer in some inflation-indexed bonds. Says Amy Falls, global fixed-income strategist at Morgan Stanley: "Genuine diversification comes from thinking of all the possible investment outcomes and preparing for them."

In the high-quality arena, the best opportunities are in the debt issued by U.S. government-sponsored groups such as Fannie Mae, as well as mortgage-backed securities guaranteed by Fannie Mae, Fannie Mae, and Freddie Mac. In Cronin, chief investment officer for fixed income at Putnam Investments in Boston, says that in mortgage-backed securities are the best bets.

PUTTING. Thanks to worries that homeowners prepay mortgages amid sliding interest rates, mortgage securities recently yielded 2.1 percentage points more than five-year Treasuries. That's up from a 0.9-percentage-point spread in January, the widest it has been since the 1989 savings and loan crisis, he says. Cronin, who sees higher interest rates next year, believes mortgage refinancings won't be as plentiful as feared. Securities issued by Fannie Mae, backed implicitly by Uncle Sam, are also tempting because they yield 0.6 percentage point more than five-year Treasuries.

The investment-grade corporate bond market offers bargains, too, says Stephen Kane, a co-manager of Metropolitan West Total Return Bond Fund. Since September 11, amid concerns that the economic slowdown will be deeper than previously expected, investors have bid up prices of financial companies and dumped bonds in the auto and travel-related sectors. As a result, Kane says the bonds of players like Ford Motor and General Motors offer good value, with yields recently 2.8 percentage points above 10-year Treasuries, up from 1.9 points in early September. "They have enough flexibility to ride out the downturn," he argues.

Many bond pros think junk bonds offer the best plays. In the past month, prices have been

Best Bond Buys

INVESTMENT	AVG. YIELD*	COMMENT
HIGH-YIELD BONDS	13.4%	Rich yields compensate investors for risks; avoid troubled sectors like telecom
I-BONDS	5.9%	Inflation-indexed U.S. savings bonds earn a guaranteed annual rate, recently 3%, plus a second rate pegged to inflation
INVESTMENT-GRADE CORPORATES	5.9%	Bargains in battered auto industry bonds like those of Ford and General Motors
MORTGAGE-BACKED SECURITIES	5.7%	Home mortgages securitized by Ginnie Mae, Fannie Mae, and Freddie Mac yield 2.1 percentage points more than Treasuries, the widest gap in more than a decade
U.S. GOVERNMENT AGENCY SECURITIES	4.0%	Debt issued by Fannie Mae and others boast solid credit quality and yields that are 0.6 percentage point above U.S. Treasuries

* As of Oct. 29

Data: BusinessWeek, Lehman Bros., Treasury Dept.

pummeled by worries about deteriorating credit quality. The average junk bond recently traded for 75¢ on the dollar and yielded 13.4%, nine percentage points more than comparable U.S. Treasuries, the widest gap since the 1990 recession. "That extra yield compensates investors for expected increases in corporate bankruptcies and credit downgrades," says Margaret Patel, manager of the Pioneer High Yield Fund.

When the economy shows signs of recovery, Jack Malvey, chief global fixed-income strategist at Lehman Brothers, expects junk bonds to rebound. "The biggest bond story for 2002 will be high-yield," he says. But Patel cautions investors to avoid troubled sectors such as telecom.

It's tough for individuals to buy junk bonds on their own because institutions dominate the market and many issues are sparsely traded, making it difficult to sell them quickly. So look for high-yield funds that go light on bonds in telecom and other distressed sectors.

Lastly, you should inflation-proof your bond portfolio. It may seem silly to think about inflation at a time when most economists think we're in a recession. Morgan Stanley's Falls says the potential for inflation is remote when the world's economies are struggling. Still, PNC's Kleintop warns that the war against terrorism, thought to be a drag on the economy, could spark inflation if it leads to an oil supply disruption.

So consider buying a type of U.S. savings bond that is indexed against inflation. Series I Bonds were recently yielding 5.92%. I Bonds can be cashed out after five years and accrue interest for 30 years. They earn a guaranteed annual rate, recently at 3%. A second rate, recently 2.88%, is pegged to the inflation rate. The bonds are exempt from state and local taxes but not from federal taxes.

Bonds may not be the answer to all your investment woes. But holding a variety of bonds can bring your portfolio some stability in these unstable times.

Opportunities in the mortgage-backed securities market are the best they've been in years, says Putnam's Kevin Cronin

The Grass Is Greener Over There

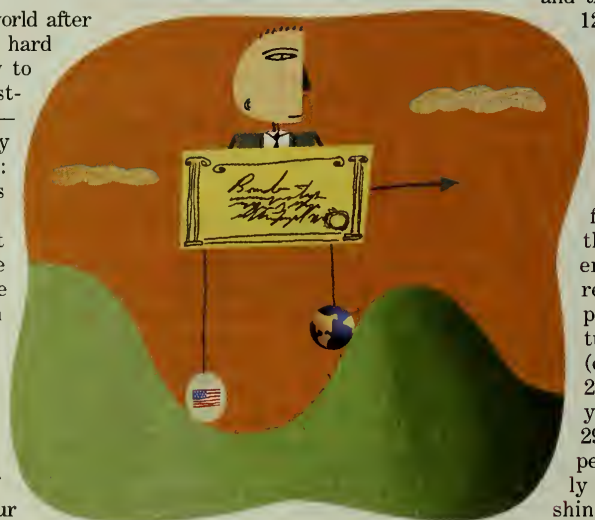
Foreign debt issues are set to outdo their U.S. rivals

BY
SUSAN SCHERREIK

In the far riskier world after September 11, it's hard to figure out how to keep your investments growing—and safe. One strategy has a lot of merit: shifting some assets into foreign bonds.

Many Wall Street bond gurus believe foreign bonds are poised to outperform their U.S. counterparts. Also, the long-robust dollar is weakening, which will benefit U.S. investors in foreign securities. And of course, spreading your investment bets cuts portfolio risk over the long haul. "Now is the time to embrace portfolio globalization," says Jack Malvey, chief global fixed-income strategist at Lehman Brothers.

So you might consider stashing up to 10% of your investments in foreign bonds, says Mary Erdoes, head of fixed-income investing at J.P. Morgan Private Bank. The easy way is through a mutual fund, which allows you to invest in a mix of bonds from different countries for as little as \$1,000. To buy individual issues, you'll need deep pockets and a broker, since these bonds trade in lots of \$1 million or more. Banks and



pricing, since by themselves foreign bonds are more volatile than U.S. debt. But if you added some foreign bonds to your investment mix over the past 16 years, you would have enjoyed higher returns with less volatility. A portfolio invested 60% in the Standard & Poor's stock index and 40% in intermediate-term U.S. government bonds from January, 1985, through September, 2001, would have earned an average 12.59% annually, says Ibbotson Associates, a Chicago investment consulting firm. Altering the mix—10% in foreign bonds, 30% in U.S. debt

and the return rose to 12.79%. The more diversified portfolio is also more volatile.

Foreign bonds would have boosted your portfolio's performance even though U.S. government bonds in recent years have posted the best returns worldwide (climbing 13.5% in 2000, and 9.1% in 2001 through September 29). But now, European issues especially are set to shine their light on their U.S. counterparts. Both in

intermediate-term U.S. and European government bonds currently yield around 4.5%. European bonds, however, could enjoy more price appreciation than U.S. debt securities as European central bankers make relatively deeper rates cuts to spur their economies, says Lehman's Malvey. He also likes the government bonds of Canada and Australia because they yield about half a percentage point more than U.S. Treasuries.

RISKING IT. Then there's the extra kick from currency appreciation. Michael Cosgrove of Econoclast, a Dallas investment firm, expects the greenback to weaken 15% to 20% against the euro, as well as the Canadian and Australian currencies, in the next three to five years. His reasoning: Foreign investors, who have flocked to U.S. markets in recent years, will shift some money to other nations as the economic prospects brighten.

If you opt to go the mutual-fund route, choose carefully. You'll want to look among international bond funds (vs. emerging markets funds) that get European bond exposure. But many put only half their assets in U.S. debt securities and also hedge currency risk. As a result, you won't get the diversification you're looking for. The problem is, few funds invest solely in foreign debt without hedging currency risk (table).

To most people, foreign-bond investing is familiar territory. But an overseas foray could yield richer returns.



Bond Funds With a Global Reach

FUND/ SYMBOL	2001 TOTAL RETURN*	3-YEAR ANNUALIZED TOTAL RETURN*
AMERICAN CENTURY INTERNATIONAL BOND BEGBX	1.66%	-2.88%
MORGAN STANLEY INTERNATIONAL FIXED-INCOME MPIFX**	-0.77%	-3.09%
T. ROWE PRICE INTERNATIONAL BOND RPIBX	0.80%	-2.45%

*Through Oct. 29

**31% of assets in U.S. government bonds

Data: Morningstar

brokerage firms, however, can act as wholesalers and arrange for their high-net-worth clients to buy the bonds in \$100,000 lots. Erdoes advises against this strategy unless you have at least \$500,000 to invest, so you can reduce risk by owning a couple of issues.

Whichever approach you pick, foreign bonds will help smooth out your portfolio's returns, because they have a low correlation with U.S. stocks and bonds. That seems sur-



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Bond Funds You Buy And Sell Like Stock

ETFs can be a low-cost way into Treasuries

BY ANNE TERGESEN

Exchange-traded funds, which resemble index mutual funds but are bought and sold like stocks, have been a big hit with equity investors. Now, Wall Street is trying to apply the same concept to bonds. ETFs tracking indexes of U.S. government bonds and other high-quality issues are expected to start trading by early next year.

Even with investors' newfound enthusiasm for bonds, these new fixed-income vehicles are not likely to enjoy the same success of equity ETFs such as "Spiders" or SPDRs (Standard & Poor's Depositary Receipts), which track the Standard & Poor's 500-stock index. For one thing, they are not nearly as diversified as bargain-priced index mutual funds that cover much of the bond market. Moreover, the tax advantages that have helped make stock

ETFs hot items do not travel well to the bond market. "I've yet to see a compelling reason for why investors need them," says Eric Jacobson, senior analyst at Morningstar, the Chicago-based firm that tracks mutual-fund performance. **FIRST WAVE.** Trading bond-fund shares on a stock exchange is not exactly a new idea. Several hundred closed-end bond funds are already available to investors. But these older funds are problematic for many since the price at which they trade can be significantly different from net asset value (NAV)—what the fund's bonds are actually worth. In contrast, the new ETFs are structured so that they rarely deviate from NAV. That's because if an ETF swings to a discount, middlemen buy the beaten down ETF shares and exchange them with the ETF's sponsor for the more highly valued component bonds. That way, the middlemen net an immediate profit and keep the share prices in line.

Barclays Global Investors and Nuveen Investments, sponsors of the bond ETFs, will bring them out under the respective names iShares and Fixed Income Trust Receipts, or FITRs. Nuveen plans to offer portfolios that mature at 1-, 2-, 5-, and 10-year intervals (table). Barclays aims to

launch five funds. One will track the entire Treasury market. Three others will zero in on specific maturities. And the last will add some age and investment-grade corporate bonds to a mix of Treasuries.

Neither Barclays nor Nuveen has yet announced the management fees they will charge for the bond ETFs. A good bet is that they will be slightly below the lowest-cost bond index funds, which charge fees in the range of 0.20% of assets. And they will be far below the fees levied on closed-end bond funds. Roll in the brokerage commissions, and the costs probably will be a little higher than for buying and holding Treasury bonds. Still, some investors may think a slightly higher cost worthwhile, given the liquidity and convenience of the ETF format.

Like most bond funds, these ETFs won't guarantee you a fixed rate of return or guarantee your investment will be recouped when you sell. Instead, you will get whatever price the ETF fetches on the exchange. If interest rates have gone up since you bought, the price will have gone down. If rates have fallen, the price will be higher.

Since the first wave of bond ETFs focuses most entirely on Treasuries, you'll have to go elsewhere to invest in other sectors, such as municipal and high-yield debt. The broad-based bond ETF, the iShares Government/Credit Bond Index Fund, covers only 60% of the Vanguard Total Bond Market Index Fund's territory. If the initial products find acceptance, Barclays, Nuveen, and others will likely roll out new bond ETFs to fill the gaps.

It's hard to see a big success here. One reason for the lack of traction of stock ETFs over mutual funds is that they're structured in a way that often allows them to avoid making the taxable capital-gains distributions that rattle fund investors. Bond funds generate nearly all their return from interest income—and there's no way to avoid paying tax on that unless, of course, the income is from tax-exempt bonds.

Even if the bond ETF isn't a killer app, it may have some appeal to those looking for a low-maintenance play in high-quality bonds.



Coming Attractions

Exchange-traded funds that track bond indexes are expected to debut early next year. Here's what is planned:

SHORT-TERM

iShares 1-3 Year Treasury Index Fund

1 Year FITRs Index Fund

2 Year FITRs Index Fund

INTERMEDIATE-TERM

iShares 7-10 Year Treasury Index Fund

5 Year FITRs Index Fund

10 Year FITRs Index Fund

LONG-TERM

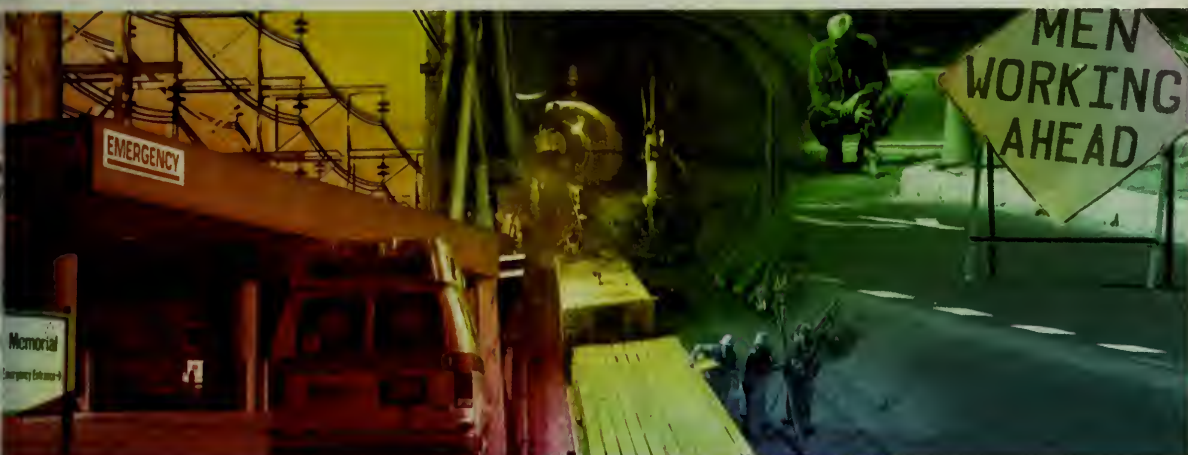
iShares 20+ Year Treasury Index Fund

ALL MATURITIES

iShares Treasury Index Fund

iShares Government/Credit Bond Index Fund

Data: Barclays Global Investors, Nuveen Investments



The Muni Maze Gets Tougher

Choose carefully to boost both safety and yield

LEWIS BRAHAM

BOND
INVESTING

Municipal bonds have had a strong run over the past 18 months, thanks first to the flight from the stock market and more recently to the Federal Reserve's aggressive interest-rate cuts. But now, muni yields, which fall when bond prices rise, are downright stingy, ranging from 2% to 5%. At the same time, many state and local governments are feeling pain from the slowdown. So is there any upside left?

Relative to U.S. Treasury bonds, munis are still attractive. The average 30-year top-rated municipal bond yields 4.96%, compared with 5.26% for 30-year Treasuries. But since muni-bond interest is exempt from federal taxes, if you're in the 30.5% tax bracket, that 4.96% is the equivalent of earning 7.14% in a taxable bond. Yields on short-term munis are low but also compare well. A 2.36% average yield on two-year munis is worth 3.4% after taxes for the 30.5% bracket. Two-year Treasury notes yield only 2.61%.

Yet finding extra yield these days takes some imagination. Now may be a good time to consider callable bonds, for instance. Investors typically shun them when rates are falling, since issuers can force their redemption in order to sell new bonds at lower rates. But with rates at their lowest in nearly four decades, bond experts think yields can't

fall much further. So why buy noncallable bonds, especially since their yields are lower than callables?

That's why Marilyn Cohen of Envision Capital Management, a Los Angeles bond adviser, is buying older callable munis, such as Philadelphia Water & Wastewater, which has its first call in 2003. Because the bond was issued in 1993, when rates were higher, it yields 4%. "There's a huge probability it will be called," says Cohen. But so what? Noncallable munis of the same credit quality maturing in 2003 are currently yielding only 2.36% on average, so all costs considered, the callable 4% bond comes out ahead.

The sweet spot in the muni market is smack in the middle—the 7-to-15-year maturity range. That's because short-term yields are too low to be attractive, while long-term bonds can be risky if rates start to climb. "Buying a 10-year municipal bond right now will give you a significant percentage of the 30-year bond's yield with only a third of its interest-rate volatility," says Joseph Deane, portfolio manager for Smith Barney Managed Municipals Fund. Indeed, the average 10-year muni yields 4.01%, and a 15-year, 4.59%,

What to Look For

ISSUER

States more dependent on income taxes than sales taxes. Watch out for states or cities where tourism is a major industry.

CREDIT QUALITY

Bonds rated A to AAA by Standard & Poor's are safest for investors.

SECTOR

Bonds issued by utilities that provide essential services—electrical, water, and sewerage—are recession-resistant.

MATURITY

Bonds with maturities of 7 to 15 years offer yields almost as high as 30-year bonds with much less interest-rate risk.

CALL PROTECTION

Buy callable bonds. Relative to noncallable bonds, yields are much higher.



Essential revenue bonds for electric power or water utilities are a good bet in a slowing economy

compared with the 30-year's 4.96%. "It's not worth taking on the extra risk for less than half a percentage point of yield," adds Cohen.

The sorry state of the economy is changing conventional wisdom in the muni market, too. Usually, general obligation (G.O.) bonds, which are funded by pooled tax revenues collected by an entire state or municipality, are considered safer than revenue bonds, which are supported by the revenues from an individual project, such as a toll bridge or hospital. The fear is that if the project fails, its revenue bond will be in jeopardy.

BEYOND BASICS. Yet entire state budgets are in trouble now. "G.O.'s issued in North Carolina and Georgia, which depend heavily on sales-tax revenues, are vulnerable to the economic slowdown," says manager Christian Swantek of Armada National Tax-Exempt Fund. Also, states that rely on tourists to fill their tax coffers, such as Florida, Nevada, and Hawaii, are suffering from a terrorism-driven slowdown. California must recover a \$12.5 billion shortfall caused by the bailout of bankrupt electrical utilities. And New York is reeling from the Wall Street bear market and the aftermath of the September 11 attacks. G.O. bonds issued in these states aren't likely to go into default, but they could fall in price.

For this reason, many pros are investing heavily in "essential-service" revenue bonds. "Electric power, water, sewer facilities—people are going to pay for these services regardless of the economic situation," says Thomas Spalding, portfolio manager for Nuveen Intermediate Duration Municipal Bond Fund. That's why Spalding invested in bonds issued by Utah's Intermountain Power Supply. (In California, the electric utilities that went bust were private companies that were suffering from skyrocketing power costs and a botched deregulation plan. California's public utilities are fine.)

Of course, not every G.O. is a suspect bond. A lot depends on how long you plan to hold it. Mutual funds are especially sensitive to changes in credit quality because their portfo-

lios are priced every day, so they may need sell a bond long before maturity. Individuals, the other hand, tend to buy and hold muni bonds until maturity. In that light, G.O.'s are still a good bet. Their long-term default rate is less than 1%. They also may be less likely to be affected by terrorist attacks than, say, a special power plant.

If you're buying individual bonds, you're better off with high-quality issues, rated from AAA, Standard & Poor's highest rating, or AAA at Moody's Investors Service. "I would not recommend individual investors buy low-rated bonds," says Steven P. Mut, portfolio manager for American Century High Yield Municipal Bond. "They require a lot of credit search." That's especially true in the

economic environment. It also helps if the bond is insured by a highly rated insurer, such as American Financial Group or MBIA. That means even if the issuer is in trouble, the bond's interest principal is guaranteed.

COMPARISON SHOP. Investors can get some good information on the Web (table). Start with www.investinginbonds.com, the Bond Market Assn.'s site. It provides a good listing of actively traded munis and has a price range for each issue it tracks. The range is significant because muni brokers typically include commissions in the prices they ask for the bonds. So it's difficult to tell whether you're getting a good price on an issue without seeing the range—the daily highs and lows of the prices at which the bonds trade.

Two of the better online bond brokers are MuniDirect.com and CSFBDirect.com. They're straightforward about their commissions. CSFBDirect charges \$3 for each \$1,000 bond, MuniDirect from \$2.50 to \$5, depending on the maturity of the bond (longer-term bonds have higher commissions). Both sites offer a bond screener that lets you search for munis by state, credit rating, maturity, and callability. MuniDirect also lets you search by muni sector and differentiate between revenue and G.O. bonds.

If all of this sounds like too much work for a 4% or 5% yield, you can buy a muni mutual fund. Just make sure the expenses are less than 0.5 percentage points. With yields so meager, you can't afford to have a fund company eating too much of your return.



Surfing for Munis

WEB SITE (WWW.) / DESCRIPTION

BONDSONLINE.COM Good news and research features. When buying, commissions are in the bond's price.

CSFBDIRECT.COM Commissions are low: \$3 per \$1,000 muni bond. Decent screener, though sectors are left out.

INVESTINGINBONDS.COM Muni quote tool gives an accurate picture of the price range for bonds. Good calculator for taxable-equivalent yield.

MUNIDIRECT.COM Commissions range from \$2.50 to \$5 per \$1,000 bond. Comprehensive screener.

MUNISTATEMENTS.COM Muni prospectuses and fiscal reports for \$7 and up.

RAW DATA



RAW MATERIALS

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FIGHTING OVER THE OPTIONS



BY TODDI GUTNER
hers@businessweek.com

Many couples going through a divorce now face the tricky task of figuring out how to value and divide the stock options they have accumulated

It used to be the assets couples fought over in a divorce were the house, the bank account, and the investment portfolio. But with an estimated 10 million Americans holding stock options, a ten-fold increase over the past decade, according to the National Center for Employee Ownership, the fighting has opened on a new front. Despite the precipitous fall in the stock market that has sent option values plummeting, "the stock-option plan is still the first piece of paper divorcing couples shove at you," says Barbara DiFranza, a family law attorney in Salinas, Calif.

The biggest problem with stock options, unlike bank accounts and investment portfolios, is that they can be extremely difficult to value. Stock options give employees the right to buy a specific number of their company's shares at a set price for a set amount of time. Options can't be exercised until they vest, usually one year after they're granted. They're most valuable when the exercise price is well below the current market price. But even "out-of-the-money" options, those in which the market price is far below the exercise price, can have some monetary value, especially if the options have a long lifespan. "The more time until the options expire, the more valuable they are," since the stock has a longer chance to recover, says DiFranza.

VESTED. Attorneys and valuation experts use many methods to value options. Even so, "it's still just an educated guess," says Ginita Wall, a San Diego accountant who specializes in divorce.

Then there's the problem of allocation. Say, for instance, a husband joins a new company just before divorcing his wife and receives a

handsome options package as part of his compensation. One of the questions attorneys need to address is why the options were granted. Was it to compensate the husband for unvested options he left on the table at his former employer, his wife would be entitled to a share they're intended as a future incentive to remain at the new company, and won't vest until after the divorce, his ex may not have a claim on them. However, according to two appellate court cases, *Kerr v. Kerr* in California in 1999, and *Moore v. Moore* in Iowa in 2000, if the couple has children, "proceeds from future stock options may be seen as income to support the family, and so the wife is likely to benefit," says Wall.

Couples also need to examine the mechanics of the stock-option plan to determine whether the company allows the husband to transfer options to his ex-wife. If he can, she can exercise them at vesting, assuming no restrictions. If he can't, she may have to work out a buy-sell contract agreement that assigns certain options to the wife that she can control through her ex-husband. Since many companies whose stock prices have plunged have reissued options at lower prices, any settlement should

allow the ex-spouse to claim the same share of new options as she had with the old ones.

The agreement must spell out how options will be handled and the proceeds transferred to the wife. "The agreement should also instruct the husband to have a power of attorney drafted so that she can exercise his wife's options in his absence," says DeVon Daniels, a Greenville (Del.) financial consultant who works on divorce settlements. The contract should also cover payment of taxes. Since taxes on the wife's exercised options will be withheld from her ex's paycheck, she'll have to make provisions to reimburse him.

Unfortunately, the law is of little help in these cases. "Dividing and valuing stock options in divorce is a newly evolving area of law fraught with an enormous amount of disagreement," says Edwin Schilling III, an Aurora (Colo.) bankruptcy attorney. Settlements will continue to be negotiated on a case-by-case basis until the courts establish more rule-setting precedents. Until then, divorcing spouses must be diligent and make sure they get their fair share of the options pie.



Divide and Conquer

Divorcing couples need to value options and create a contract for splitting them

- Specify which options belong to whom
- Direct the nonemployee ex-spouse to make transaction requests in writing
- Give the length of time the employee ex-spouse has to complete transactions
- Specify how proceeds from option sales and dividends will be transferred
- Explain how taxes will be paid

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SIEBEL

THE OIL SPIGOT MAY BE CLOSING



BY ROBERT BARKER
rb@businessweek.com

Veteran energy analyst Charley Maxwell sees prices trending upward. That has vast implications for investors

A few days ago, in one of Walt Disney World's cold, cavernous hotel ballrooms, a tall, silver-haired man took the podium. He would turn 70 in two days, and he was hoarse. But for this meeting of financial advisers, he had a warning, one so grave he has resolved to keep sounding it as best he can. So he pressed on.

Visionaries, whom I define as anyone predicting anything more than 36 months away, rarely get my attention. But Charles Maxwell, senior energy analyst for institutional broker Weeden & Co., is an exception. And not just because three decades back he coined the term "energy crisis," or because he has often proved correct in calling oil's swings. Now, he thinks that oil prices by 2006 or so will be sharply and permanently higher—an inevitability that will put the U.S. in a serious economic and political bind.

This view runs counter to today's market, which after a pop upward after September 11 has seen oil fall in price, from \$27 a barrel before the attacks to \$22 lately. To Maxwell, it's not just that the price doesn't fully reflect the greater risk of an interruption in the flow of oil from the Mideast with the U.S. at war and Saudi Arabia more unstable than ever. Despite slow global growth, the oil market remains tight. By next summer, when Maxwell expects the economy and energy use to pick up, oil prices will turn up, too. "We're going to see tighter and tighter conditions," he said. "We're at the bottom now, at \$22."

TAR SANDS. When spikes up or down are always possible, Maxwell means a long-term bottom. He sees crude prices, which since 1974 have typically ranged from \$10 to \$30 a barrel, slowly trending higher as non-OPEC oil fields play out. Unlike some petro-pessimists, Maxwell doesn't pinpoint a date when world production will peak. That entails too many imponderables, such as Iran and other relatively closed states where credible oil-field data are scarce. But non-OPEC production is more readily figured. He sees non-OPEC output, even with the big, new Caspian Sea fields, topping out in 2005 to 2007. "That's where the rubber will meet the road," Maxwell said. "The non-OPEC world will have to repair to the OPEC world and say, 'Please, sir, may I have more?'"

Six nations—Saudi Arabia, Iran, Iraq, Kuwait,

the United Arab Emirates, and Venezuela—be able to pump extra barrels to feed rising global demand. But they also will enjoy strong pricing power. "They see a golden age dawn for them," Maxwell said. As OPEC nations move up for years of—in their view—being shocked, oil prices will rise, faster than inflation, year after year. "The SUV would be thrown onto the ash heap of history," he said. "We will all have to change our lifestyles."

Not every energy analyst sees it this way. DRI-WEFA Chief Energy Economist Michael Lynch says output models used by Maxwell and other pessimists are inherently flawed. "Ninety-eight percent of the forecasts are



Maxwell's Picks

COMPANY/SYMBOL	PRICE*
GONOCO (COC)	\$27.15
IMPERIAL OIL (IMO)	28.33
PHILLIPS PETROLEUM (P)	57.51
SUNCOR ENERGY (SU)	31.04

*As of Oct. 29
Data: BusinessWeek



too low," he told me. Yet Maxwell is even partly right: the implications for investors would be vast. He thinks service outfits such as Baker Hughes will benefit from field exploration, while production companies with unusual reserves, such as Canadian and Venezuelan tar sands, will

be revalued upward (table). Any industry, from autos to cement, that relies heavily on energy will find its profit growth handicapped.

The social dislocations and political upheavals worry Maxwell most. With power shifting from OPEC and even the reinvigorated Russian oil industry, he told me, "we're going to have to either conform politically and reduce our position as a great power or find ways around the problem. Solutions? Switching to coal and other fuels, conservation remain the best bets. "We will make America in another image," he said. "President Carter will come back. He'll be 101 years old, but he'll be standing there in all of his glory wearing a sweater." Charley Maxwell is a realist with a full view of winter.

BusinessWeek online

For more on energy stocks, go to barker.online.at or www.businessweek.com/investor/ and click on "Column"

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put our feelings
into words.

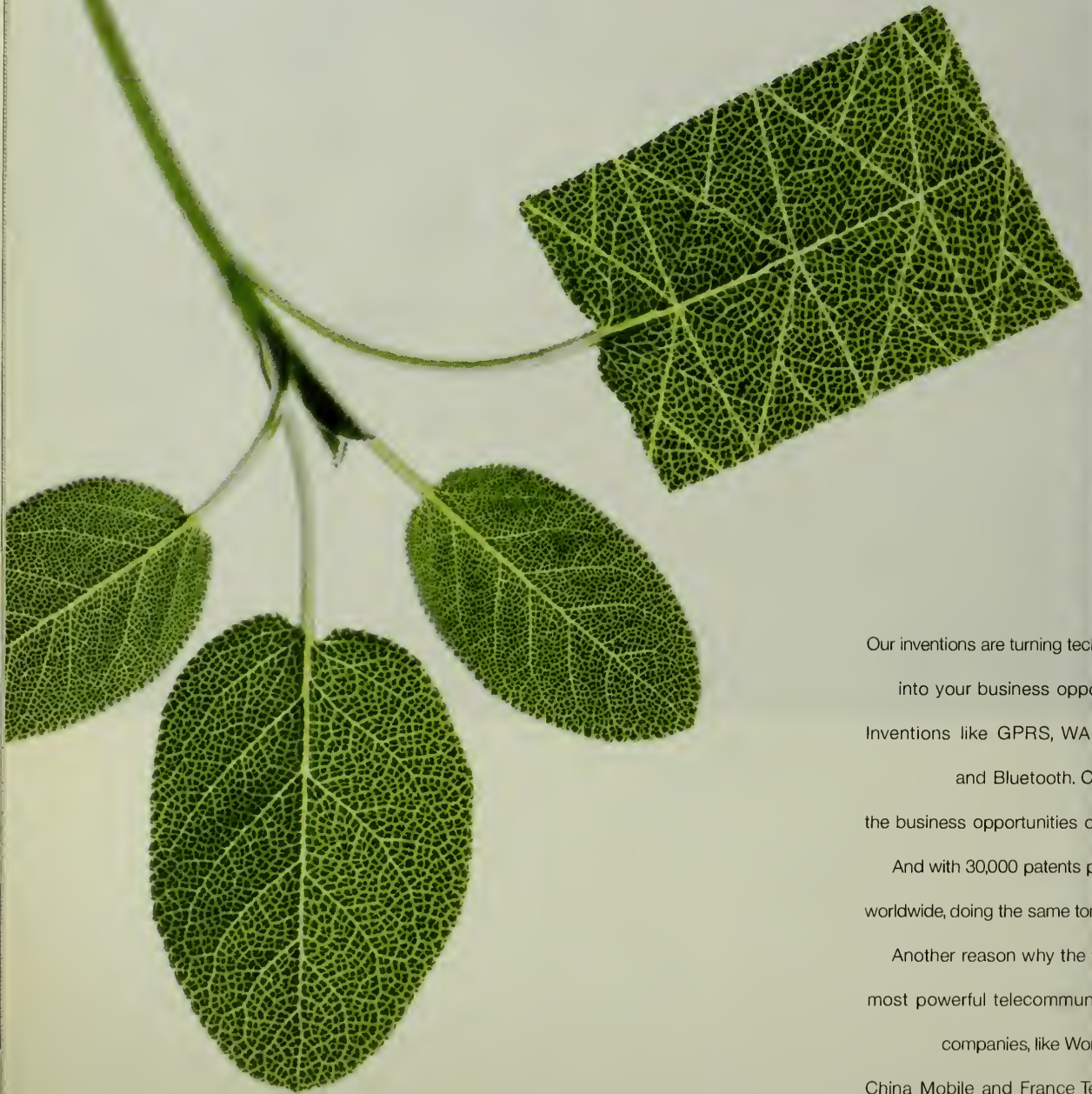
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Specialty insurer Universal American Financial (UHC) zeroes in on a target most rivals shy away from: old folks. That's just dandy for Universal, whose products—supplemental Medicare and long-term-care coverage, among others—appeal mainly to people 65 and up. If present trends continue, the percentage of the population over 65 will nearly double in 30 years. That points to rapid growth for Universal's revenues and earnings—despite insurers' current mountain of claims from the September 11 attacks. That debacle had no great impact on Universal's sales or earnings, notes Jason Zucker, an analyst at Banc of America Securities, who has a strong-buy rating on the stock, now trading at 6.35.

In addition, Universal provides administrative services to other insurers for their senior policyholders. GE Capital, Consec, Mutual of Omaha, and AEGON outsource this business to Universal.

One other little point: Universal, with total assets of \$1.1 billion in 2000, is an attractive acquisition target as it gains ground in the senior market, says Zucker. Management recognizes, he says, that as a small player in a consolidating industry, Universal can't stay independent for long. Also, its largest shareholder, Capital Z Partners, with a 44% stake, might "welcome an exit strategy" through a buyout, says Zucker. Other insurers have been bought at 2.5 times book value. He puts Universal's book value at \$4.14 a share. Zucker figures Universal will earn 52¢ a share in 2001 and 59¢ in 2002.

VERMONT PURE MAY GET SIPHONED OFF

Take a big gulp of Vermont Pure Holdings (VPS), the bottler and distributor of such brands as Vermont Pure and Hidden Springs. The company is the only remaining publicly traded pure play in U.S. bottled water. After a wave of buyouts, the U.S. water market is

dominated by Nestlé of Switzerland, which owns Perrier, Deer Park, and Poland Spring; Groupe Danone of France, owner of Evian; Suntory Water, with Crystal Springs; PepsiCo, with Aquafina; and Coca-Cola, with Dasani.

Vermont Pure, the eighth-largest U.S. bottled-water company, serves more than 85,000 home and office customers. It recently signed private-label deals with supermarket giants Royal Ahold and Hannaford Brothers. Ver-

mont, now trading at 3.50, remains an "attractive acquisition candidate," says Taglich Brothers analyst Howard Halpern, who rates the stock a "speculative buy." The company's size and strong brand—plus its bottling facilities and own source of spring water—should attract a premium price in a buyout, says Halpern. "Danone and Suntory have been the most active in acquiring bottled-water companies," says Halpern, who notes that recent acquisitions have been valued at 10 to 15 times cash flow. He values Vermont at 14 times EBITDA (earnings before interest, taxes, depreciation, and amortization), or \$7.85 a share.

One takeover investor, who values the company more highly—at \$9 to \$12 a share—says Vermont has already been approached by a suitor. The company's CEO did not return the call.

PROTEIN-RICH AT CIPHERGEN?

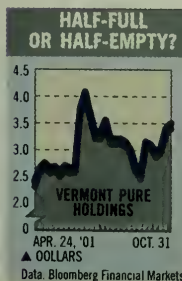
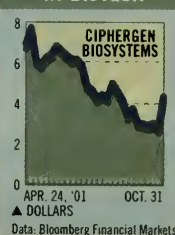
Institutional investors are warming up to Ciphergen Biosystems (CIPH), which hit 35 a share in November, 2000. It has since tumbled to 4.45, along with the market's massive fall and the cooling of interest in biotechs. Ciphergen, however, has what analysts call "exciting products" in proteomics, the study of proteins. And there is talk that Ciphergen is buyout bait—like Vysis, a maker of clinical products for the evaluation of genetic diseases, which Abbott Laboratories agreed on Oct. 24 to acquire.

Ciphergen has developed a proprietary system called ProteinChip, which helps drugmakers identify and characterize proteins. It is a novel tool in protein research: It helps pharmaceutical houses to understand the role of proteins in the biology of disease and its progression—as well as the therapeutic effects of drugs. Customers including Pfizer, AstraZeneca, Novartis, and GlaxoSmithKline use ProteinChip in preclinical development of drugs.

"We view Ciphergen as the leading pure-play proteomics company and rate it a buy," says analyst Eric Schmidt of SG Cowen Securities. Carl Gordon, a partner at OrbiMed Advisors, which holds a 9% stake, thinks Ciphergen would be a "perfect fit" for the likes of Applera's Applied Biosystems, which makes instrument systems and software for life-science research. He says Ciphergen in a buyout would be worth more than \$8 a share. Revenues have been building up, he says, from \$8.9 million in 2000 to an estimated \$18 million in 2001. Ciphergen should be in the black in 2003, says Gordon.



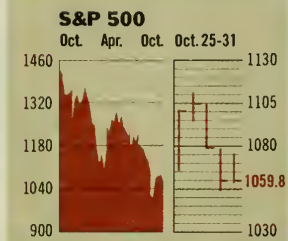
AFTER DARK DAYS IN BIOTECH



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

No treats on this Halloween: Stocks were battered as evidence of a U.S. recession mounted. The Commerce Dept. announced on Oct. 31 that the economy shrank 0.4% in the third quarter. The day before, the Conference Board reported consumer sentiment in October fell to the lowest level since February, 1994. The Dow, Nasdaq, and S&P 500 fell 2.9%, 2.4%, and 2.3%, respectively.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Oct. 31	Week	Year to date	Last 12 months
S&P 500	1059.8	-2.3	-19.7	-25.9
Dow Jones Industrials	9075.1	-2.9	-15.9	-17.3
Nasdaq Composite	1690.2	-2.4	-31.6	-49.8
S&P MidCap 400	450.8	-1.1	-12.8	-13.3
S&P SmallCap 600	202.9	0.0	-7.6	-7.1
Wilshire 5000	9796.9	-2.0	-19.5	-26.4

SECTORS

	Oct. 31	Week	Year to date	Last 12 months
BusinessWeek 50*	695.7	-2.1	-28.3	-39.0
BusinessWeek Info Tech 100**	372.0	-3.6	-34.2	-54.0
S&P/BARRA Growth	546.5	-2.4	-20.5	-32.1
S&P/BARRA Value	513.1	-2.3	-19.3	-19.8
S&P Energy	811.8	-0.1	-12.9	-10.9
S&P Financials	135.1	-2.8	-18.0	-16.0
S&P REIT	87.8	1.2	-0.2	7.3
S&P Transportation	603.7	1.0	-13.4	-9.6
S&P Utilities	245.6	0.5	-29.9	-24.4
GSTL Internet	81.9	-7.4	-54.9	-75.2
PSE Technology	598.9	-2.6	-26.5	-38.4

*Mar. 19, 1999 = 1000 **Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

Group	Last month %	Last 12 months %
Oil & Gas Drilling	35.7	48.3
Communications Equip.	23.6	43.0
Toys	20.2	42.8
Semiconductors	19.9	41.6
Computer Systems	16.3	39.8

GLOBAL MARKETS

	Oct. 31	Week	Year to date	Last 12 months
S&P Euro Plus (U.S. Dollar)	1003.8	-2.6	-19.7	-25.9
London (FT-SE 100)	5039.7	-2.5	-15.9	-17.3
Paris (CAC 40)	4341.3	-3.2	-31.6	-49.8
Frankfurt (DAX)	4559.1	-5.3	-12.8	-13.3
Tokyo (NIKKEI 225)	10366.3	-4.0	-7.6	-7.1
Hong Kong (Hang Seng)	10074.0	-1.4	-19.5	-26.4
Toronto (TSE 300)	6885.7	-0.2	-	-
Mexico City (IPC)	5537.0	-3.0	-	-

FUNDAMENTALS

	Oct. 30	Wk. ago	Year to date	Last 12 months
S&P 500 Dividend Yield	1.47%	1.44%	-	-
S&P 500 P/E Ratio (Trailing 12 mos.)	42.3	39.3	-	-
S&P 500 P/E Ratio (Next 12 mos.)*	20.3	20.6	-	-
First Call Earnings Surprise*	1.20%	1.18%	-	-

*First Call Corp.

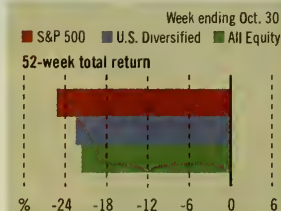
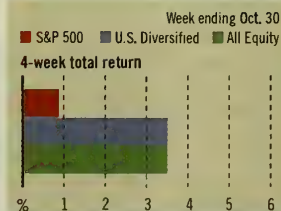
TECHNICAL INDICATORS

	Oct. 30	Wk. ago	Year to date	Last 12 months
S&P 500 200-day average	1203.1	1208.8	-	-
Stocks above 200-day average	35.0%	38.0%	-	-
Options: Put/call ratio	0.87	0.73	-	-
Insiders: Vickers Sell/buy ratio	-2.64	1.60	-	-

WORST-PERFORMING GROUPS

Group	Last month %	Last 12 months %
Photography/Imaging	-21.4	-
Savings & Loans	-18.3	-
Long Dist. Telecomms.	-17.6	-
Personal Loans	-17.1	-
Specialty Chemicals	-13.8	-

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

Category	4-week total return %	52-week total return %
Leaders		
Technology	15.8	28.6
Natural Resources	7.2	8.8
Pacific/Asia ex-Japan	7.0	5.0
Small-cap Growth	6.6	1.1
Laggards		
Utilities	-3.8	-58.3
Real Estate	-3.1	-54.7
Precious Metals	-2.8	-37.0
Financial	-1.8	-36.2

EQUITY FUNDS

Fund	4-week total return %	52-week total return %
Leaders		
ProFunds OTC Inv.	550.6	153.8
ProFunds UltraBull Svc.	403.2	144.3
Conseco Science & Tech. A	39.8	124.9
Berkshire Technology	38.6	113.9
Laggards		
ProFunds UltraShort OTC	-30.5	-84.8
Rydex Dynamic Vent. 100	-29.3	-84.6
Potomac OTC Short	-15.7	-82.9
Rydex Arkots Investor	-15.5	-82.8

Interest Rates

	Oct. 31	Week ago	Year to date	Last 12 months
KEY RATES				
MONEY MARKET FUNDS	2.53%	2.60%	-	-
90-DAY TREASURY BILLS	2.01	2.16	-	-
2-YEAR TREASURY NOTES	2.42	2.69	-	-
10-YEAR TREASURY NOTES	4.23	4.59	-	-
30-YEAR TREASURY BONDS	4.87	5.33	-	-
30-YEAR FIXED MORTGAGE†	6.46	6.58	-	-
†BancQuote, Inc.				
BLOOMBERG MUNI YIELD EQUIVALENTS				
Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.				
	10-yr. bond			
GENERAL OBLIGATIONS	3.97%			
TAXABLE EQUIVALENT	5.75			
INSURED REVENUE BONDS	4.17			
TAXABLE EQUIVALENT	6.04			

THE WEEK AHEAD

VEHICLE SALES Monday, Nov. 5 ▶ Sales of U.S.-made and imported cars and light trucks probably totaled an annual rate of 19.3 million units for October, driven by incentives such as 0% financing.

FOMC MEETING Tuesday, Nov. 6, 9 a.m. EST ▶ The Federal Reserve Board's Open Market Committee will meet to set monetary policy. About two-thirds of the economists surveyed by Standard & Poor's MMS, a unit of The McGraw-Hill Companies, expect a quarter-point cut in the

federal funds rate, with the remainder projecting a half-point cut.

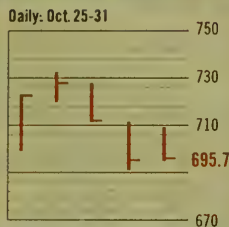
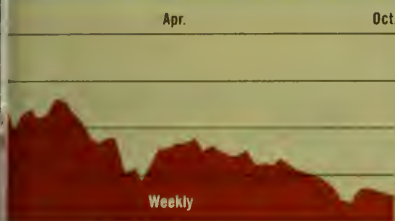
PRODUCTIVITY & COSTS Wednesday, Nov. 7, 8:30 a.m. EST ▶ Output per hour worked in the third quarter is projected to have grown at an annual rate of 0.5%. Unit labor costs likely advanced 3.2%.

INSTALLMENT CREDIT Wednesday, Nov. 7, 3 p.m. EST ▶ Consumers probably pared \$800 million of debt in September, after adding \$2.3 billion in August.

EXPORT-IMPORT PRICES Thursday, Nov. 8, 8:30 a.m. EST ▶ Import prices for beer are forecast to have fallen 0.3% while export prices likely declined. In September, import prices rose while export prices inched up 0.1%.

PRODUCER PRICE INDEX Friday, Nov. 9, 9 a.m. EST ▶ Producer prices of finished goods in October likely fell 0.2%, increasing 0.4% in September. Energy and food, October core price probably rose 0.1%, after rising 0.1% in September.

BusinessWeek Fifty

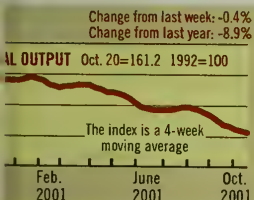


week for the BW 50, which lost 2.1%. Among those hit hard were such financials as Citigroup down 3.0%. The bright spots were tech heavyweights Sun Microsystems, up 10.4%, and Teradyne, up 5.7%. Xilinx, the biggest maker of programmable chips, ended the week telling analysts its orders had not slowed in the aftermath of September 11.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
National Petroleum	-1.3	-10.0	26	Verizon Communications	-0.6	2.8
Petroleum	1.7	-10.2	27	Citigroup	-3.0	-6.4
	5.1	-44.2	28	Sun Microsystems	10.4	-49.4
	-3.7	-23.5	29	Merck	-4.8	-20.0
Materials	-3.5	-24.7	30	El Paso	2.6	-31.0
Financial	-6.7	-92.1	31	Altera	-4.2	-20.4
Oil Petroleum	0.6	6.1	32	Marsh & McLennan	-5.0	-8.2
	4.5	-13.0	33	Household International	-5.7	-10.4
Energy	4.0	-11.0	34	ChevronTexaco	1.9	2.0
	-7.5	-36.6	35	SBC Communications	-2.8	-16.2
Procter & Gamble	-0.2	-8.5	36	Mercury Interactive	-10.4	-59.6
	-1.3	-71.3	37	AOL Time Warner	-3.1	-29.3
	5.0	-74.7	38	Washington Mutual	-2.3	-10.4
Laboratories	0.3	10.7	39	General Dynamics	-1.7	21.6
Bank of America	-6.0	-19.9	40	Comcast	-0.8	-17.2
Technology	1.6	-36.6	41	Morgan Stanley Dean Witter	-2.2	-23.1
	4.4	-26.7	42	Tellabs	7.4	-68.4
Hess	-5.2	-18.9	43	Exxon Mobil	-1.0	-3.1
Argonne	3.5	-7.2	44	Scientific Atlanta	-10.8	-54.8
Communications	-6.6	-58.9	45	U.S. Bancorp	-2.3	-23.5
Financial	-9.9	-26.0	46	Paychex	-4.0	-18.7
Petroleum	-2.4	1.7	47	Merrill Lynch	-3.0	-27.2
Services	-1.8	-7.8	48	Bed Bath & Beyond	-6.8	0.0
Resources	1.4	-19.0	49	Texas Instruments	-6.2	-13.6
Health	-5.7	0.6	50	Teradyne	5.7	-25.6

Production Index



Production index declined for the eleventh consecutive week. Before calculation of the four-week moving average, the index fell to 159.4, from 161. On a seasonally adjusted basis, all but one component finished lower. Auto and truck assemblies led the decline, as producers announced fourth-quarter production would be 1.9% lower than previously planned. Steel, power, coal, lumber, and rail-freight traffic were down. Only crude-oil refining was higher. Source: Bureau of Economic Analysis. For more information on the production index, visit www.businessweek.com. Copyright 2001 by The McGraw-Hill Companies.

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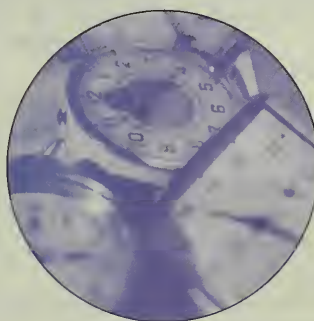
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For more investment data and the components of the production index, visit www.businessweek.com.

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AMERICA AND RUSSIA: AN HISTORIC MOMENT

War creates unexpected alliances, and in the war on terrorism none has been more surprising than the growing closeness between America and Russia (page 66). For the first time in our lives, a chance exists to forge deep strategic, economic, and cultural ties between these former enemies. President Bush and President Vladimir V. Putin should grab the opportunity when they meet for a summit on Nov. 12. A U.S.-Russian alliance is of such historic scope that it could shape world events beneficially for years to come. Indeed, the war on terrorism and a U.S.-Russian pact to fight it might well define much of the early 21st century.

The chances of a deal are good. Unlike his predecessors, Putin is not coming to Washington with a begging bowl, but with real assets. In America's battle with Islamic fundamentalists, Russia can offer geography, energy, and a willingness to fight terrorism. Its 11-time-zone land mass borders the Middle East and Central Asia. Oil output is second only to Saudi Arabia's, with huge reserves. Its KGB, which acted through the Stasi in East Germany (where Putin was stationed) to finance terrorism in the cold war, still retains good intelligence contacts. Russia has expertise in bioterrorism—with deep knowledge of anthrax. And it has for centuries battled Islamic expansionism on its southern flank.

Russia also holds the key to Bush's plan to ditch the Anti-Ballistic Missile Treaty and build a new missile-defense system. If the U.S. and Russia can agree to a sharp cut in the

number of nuclear warheads each side holds, to 1,500, it will sign on. The Europeans have said they will follow. This would be a big win for Bush.

America also has plenty of chips to bring to the table. Putin desperately needs investment and technology to modernize his country's economy. The U.S. can offer this and more. It can help Russia get into the World Trade Organization, which would integrate it into the global economy and pressure on Russian companies to drop their corrupt practices and adopt modern modes of operation.

A U.S.-Russian alliance would change global geopolitics. It would end the Chinese attempt to cozy up to Russia, bolster its power vis-à-vis America. It would elevate Russia's status to the U.S. as perhaps the most important country in Europe after Britain. It might even mean the eventual transformation of NATO from a military to a political organization that Russia would join.

Throughout its history, Russia has vacillated between East and West—torn between joining an open world system and retreating into continental isolationism, between Western democratic values and traditional authoritarianism. Even today there are strong forces within Russia opposing Putin's proclivities with the West. After the fall of communism, the U.S. and Russia stumbled badly in their efforts to find common ground. Now both countries have a second chance. Bush and Putin should seize it and make history.

PRAGMATISM SHOULD TRUMP POLITICS

President Bush and Administration officials are fond of quoting Winston Churchill, finding inspiration in Britain's great Conservative wartime Prime Minister. But missing from the barrage of Churchillian phrases—"victory at all costs," "we shall not fail or falter," "civilization will not last..."—is the deeper message of Churchill's political behavior. Faced with war, Churchill stared down members of his own party to create a government of national unity that mobilized the citizenry for the long haul. He had little patience for ideological discussion or class warfare either within the Tories or between them and the Labor Party.

This is a lesson the Bush Administration must take to heart. Just weeks after thousands died in plane attacks, as still more succumb to bioterrorism, Washington is reverting to business as usual. In this time of war, partisan bickering over economic stimulus and airport security is disgraceful.

Bush should take the war effort to a higher level. First, he must mobilize his own party. It matters little whether airport security is fully federalized or partially federalized. What matters is getting it done fast to bolster confidence. Pragmatism and speed trump ideological debates about the size and role of government. Just get it done.

Bush must mobilize the country as well. That's what does matter how the stimulus package is constituted. With firefighters, police, and postal workers bearing much of the brunt of the attacks, and with unemployment rising sharply, it is critical for Washington to appear fair to all groups in society. Tax cuts and benefits must be equitably distributed so no one feels disenfranchised. This is not the time to pander to lobbyists or parse each bill with an eye on the 2004 Presidential election. Bush must rise above politics to fight this war.

Like Churchill and Franklin D. Roosevelt, Bush must reach out beyond his immediate circle and mobilize the nation's best minds. Information technology, bioengineering, and communications are the U.S.'s most potent weapons for combating terrorists. Bush needs outsiders from Silicon Valley, the top biotech labs, and the best communications companies directly involved in the wartime effort.

To his credit, Bush said from the very beginning that this was going to be a long and difficult battle. Sadly, that is turning out to be true. The President must acknowledge the gravity of his predicament and mobilize his party, his government, and his country for a bitter conflict. Bush must as much as be Churchillian in deed, as well as in word.

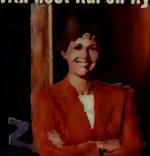
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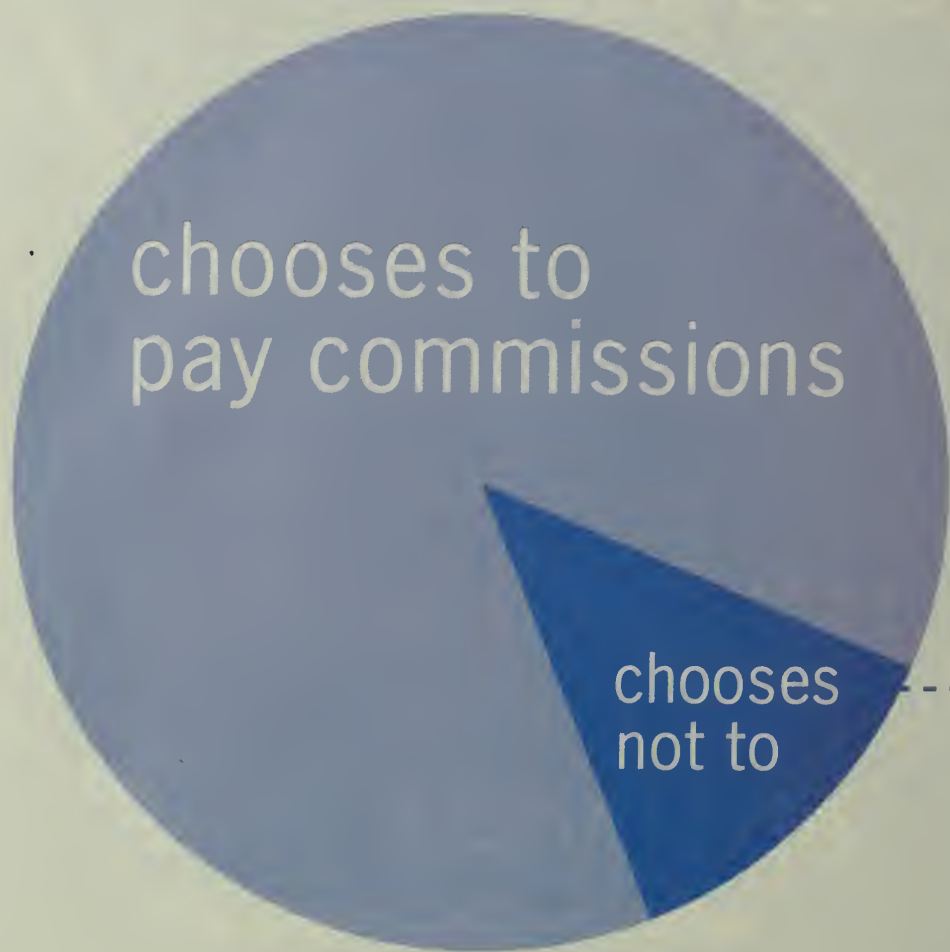


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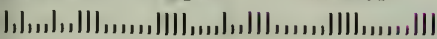
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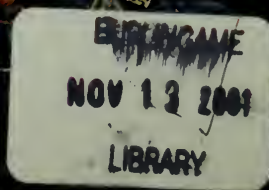
CEO SCOTT McNEALY
sees himself as the last
challenger to Microsoft's
bid for Web domination.
Is his plan realistic? PAGE 104

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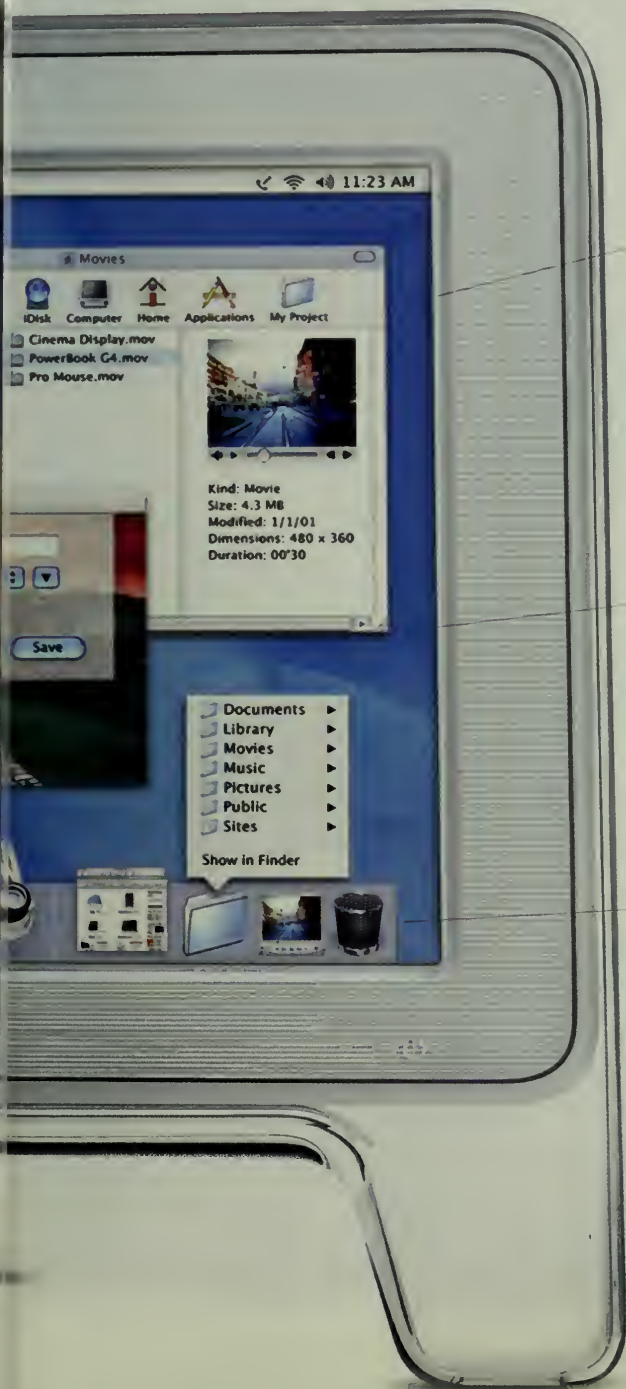
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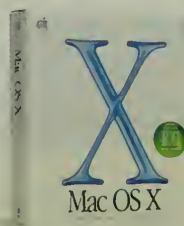
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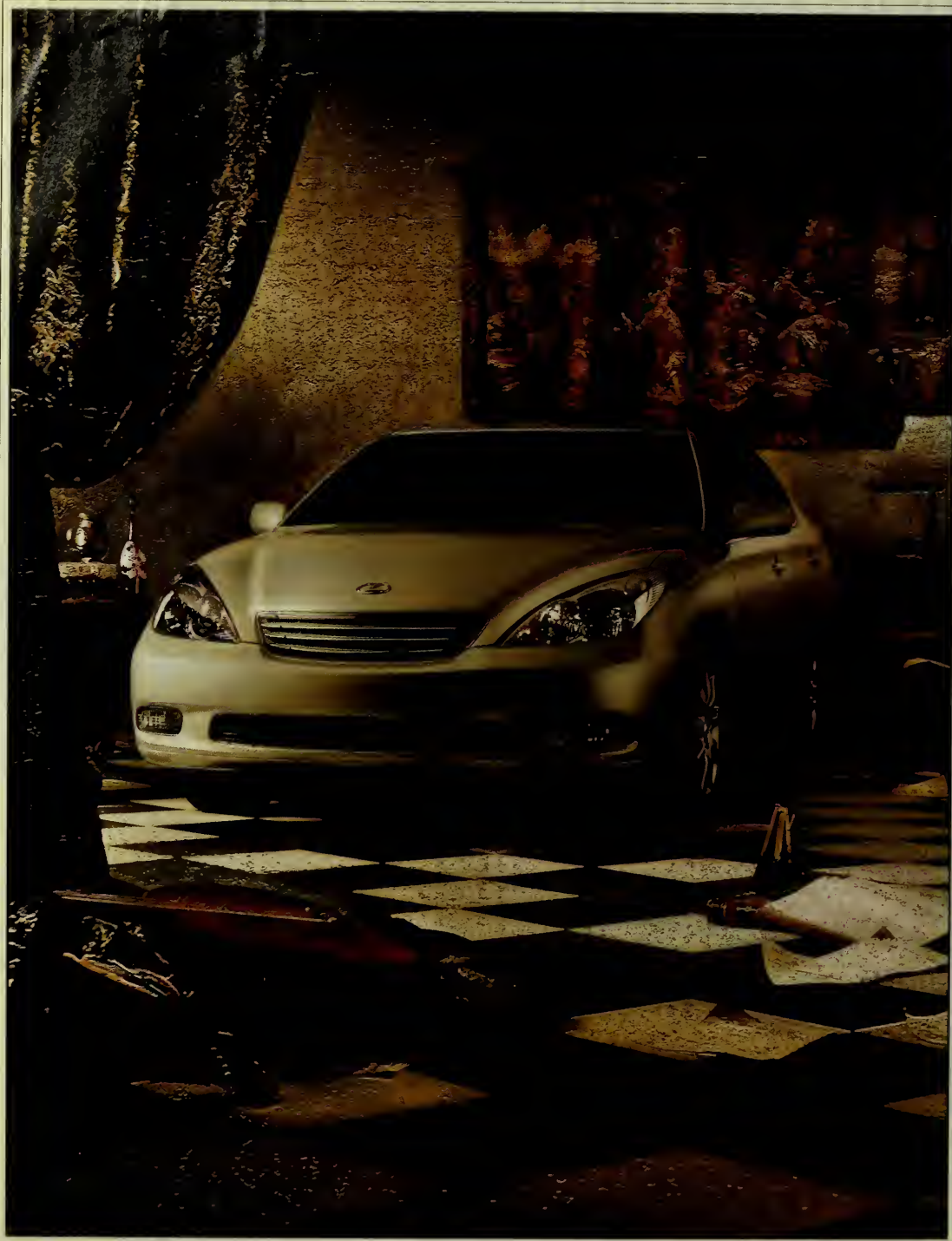
"Apple's new Mac OS X is a real peach. With the devices around my home office, OS X outplugged and outplayed Windows. Music and video were equally a breeze. Transferring tunes to a portable MP3 player is a cinch and the iMovie video editing program was a pleasure."

—Edward Baig, USA TODAY

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We're not suggesting the all-new Lexus ES 300 should hang in the Louvre. But as an outstanding example of the carmaker's craft, it's most certainly worthy of attention.

Artful design is apparent in the sleek new body of the ES 300, which has been totally restyled for improved aerodynamics as well as aesthetics.

Inside the passenger compartment, you will find a whole new world of luxury. The cabin itself is roomier and trimmed in leather* of a quality that's normally reserved for sedans costing far more. Run your hand along the sculpted contours of the driver's seat — the seams almost feel hand stitched. Burlled walnut accents adorn the dashboard, the console and the door panels.

Sophisticated sound absorption technology creates a hushed atmosphere, in the quietest ES 300 cabin ever. But, with the option of a Mark Levinson® Premium Sound System, one

of the finest audio systems possible, you may find quiet moments an all-too-rare occurrence.

In their effort to engage all of your senses, Lexus engineers haven't overlooked the most important one: your sense of safety. To that end, a new, three-stage driver's-side airbag and new full-length side-curtain airbags

have been added, which help provide protection in the event of a severe frontal or side-impact collision.†

Admittedly, the new ES 300 is not the kind of art you simply want to sit in front of and

admire. This automobile calls out to be driven. And with a 210-horsepower V6 engine mated to a new, five-speed automatic transmission, it could certainly qualify as performance art.

But perhaps the question we posed earlier is best answered by yet another question.

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On 1 January 300 million Europeans in 12 countries will wake up to a new currency: the euro. The euro is not new: it's been used in electronic transactions and by banks and international businesses since January 1999. But with the upcoming launch of euro banknotes and coins,

anyone who lives, does business or is travelling in any of the 12 countries will benefit from dealing in just one currency.

There are seven euro banknote denominations, which can be recognised easily by their look and feel: the larger the banknote, the higher the value. On one side, the banknotes show windows and gateways, symbolising a spirit of openness. On the other, they feature bridges, signifying co-operation between the nations of Europe and the rest of the world.

The eight euro coins have a common side and a national side. The common side shows the value of the coin. The national side differs from country to country and features, for instance, a head of state or a unique national symbol. You will be able to use all the coins in each of the 12 countries. The launch of euro banknotes and coins will, however, have a profound impact way beyond the participating countries.

Indeed, for businesses and individuals alike, 1 January will mark the beginning of a brand new era as, for the first time in the history of Europe, 12 national currencies make way for just one: **the euro.** www.euro.ecb.int

Euro banknotes will be available in denominations of €5, €10, €20, €50, €100, €200, and €500. The official symbol of the euro is €; the official abbreviation is EUR.



The countries sharing the euro: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain.



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COVER STORY

DEFIANT SUN

Does Scott McNealy have the technology it takes to stop Microsoft from dominating Web services?

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"I don't want to leave my children to a Microsoft-only world," says Sun Microsystems CEO Scott McNealy. Dismayed by what he calls the rap-on-the-knuckles antitrust settlement with Microsoft, he's challenging the software king on the Web. So Sun has shifted into overdrive to create the basis for a new generation of Web services. McNealy had better keep the accelerator to the floor

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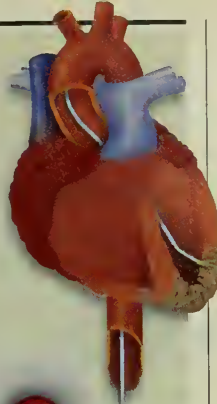
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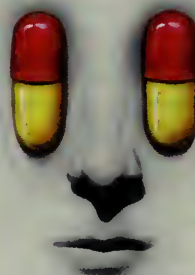
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Enlisting Insects

Teaching bees to sniff out land mines is just one approach military researchers are taking in an effort to exploit nature's amazing expertise. The findings could help the war on terror



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Up Front

EDITED BY SHERIDAN PRASSO

ECONOMIC FALLOUT

RETURN OF THE PAYROLL SCROOGE

IF THEY AREN'T CUTTING THE payroll, they're definitely cutting salary increases. Half of all companies, from all economic sectors, are likely to give smaller raises to white-collar employees next year—if any at all, compensation consultants say.

Already, a study by Mercer Consulting finds, 19% of 340 companies surveyed have cut next year's raises, from 4.5% on average to 3%. Another 11% will postpone raises by six months; 2% will scrap raises altogether, with no cost-of-living increases either. And, says Mercer's Steven Gross, who did the study, there'll be more of this



if the economy stays soft. "This is definitely a white-collar recession," he says.

It'll be worse at the top. Compensation for CEOs is likely to fall by a third (page 118). Consultant Frederick Cook says that's appropriate, since CEOs are well-paid in good times: "Now is not the time to treat execs better. If anything, you might freeze the execs and give 2% to the rest." Kimberly Weisul

CAR TALK

HOW BOB LUTZ IS REDESIGNING GM

ONLY TWO MONTHS INTO THE JOB AS HEAD OF PRODUCT development at General Motors, car guru Bob Lutz has succeeded in shaking things up. He's rearranged the approval process for new models to give designers greater say and sent a batch of vehicles back to the drawing board. What's more, sources say, Lutz has a handshake agreement with a new design chief with a European background. If it comes off, the

handpicked hire would take over from GM's current vice-president for design, Wayne Cherry, even before he retires next year. An official announcement is expected by the end of this year.

The new design chief will have more power than Cherry had for most of his tenure at GM. Before Lutz took over design and engineering operations, final styling for new cars was approved by vehicle line execs. They were typically engineers with MBAs—never designers. Now Lutz and the design chief get the final nod. "I have reempowered design," says Lutz.

Lutz has also heavily edited some concept cars GM will show at the Detroit auto show in January. He's reworking the Chevrolet Bel Aire—GM's answer to the Ford Thunderbird—and asked designers to soften the angular GMC Terra4 SUV and alter the front of the Sky Saturn convertible. Says Lutz: "There were some concepts that were wide of the mark." David Welch



LUTZ: Giving designers clout

TALK SHOW "We see the same intolerance of dissent, the same mad global ambitions, the same brutal determinations to control everyday life, and all of life."

—President Bush comparing al Qaeda to totalitarians and fascists of the past century

REALTY CHECK

HOW CHEAP IS MY VALLEY?

PLENTY OF WORDS HAVE BEEN used to describe Silicon Valley—ostentatious and arrogant among them. But affordable? Surprisingly, the

economic downturn is turning the pricey region into a bit of a bargain, relatively speaking.

Consider this: The asking price for Silicon Valley office space in September, 2001, was down 40% from its high in the final quarter of 2000,

while vacancies have shot up to 13.5%, says BT Commercial Real Estate. It's the highest vacancy rate since 1995, leaving space seekers with plenty of room to negotiate. Median housing prices in the heart of Silicon Valley, though still steep, are off 3%, while sales have plunged 38% from a year ago, says the California Association of Realtors. Anecdotal evidence suggests that salaries for the

growing pool of available shot engineers and other Tech Land have slid by as much as 30%.

The upshot? Some companies, for the first time considering Silicon Valley place to call home. No Corp., for example, a ware startup based



FOR SALE: Marked down

Rochester, plans to move its headquarters to the area early next year.

Comp founder M Brandt says can get furnished, state-of-the-art office space for a what he pays Rochester. year ago

could say it wasn't feasible to make the move because of the costs," says Brandt. "You can't make that argument anymore." Although housing is still more expensive than elsewhere, Brandt and other entrepreneurs in the rich talent pool, sizeable venture capital community and array of services available for tech startups may find the benefits far outweigh the negatives. Linda Himelstein

THE LIST PAID TO BE IN HARM'S WAY

Here's what those on the front lines can earn. Some also get hostile-environment pay and other allowances:

ARMY RANGERS		NAVY	
COLONEL	Head of a combat unit \$79,409	CAPTAIN	Command of an aircraft carrier \$83,614
SOLDIERS	\$18,007 to \$48,729*	LIEUTENANT	Pilot on an aircraft carrier \$31,450 to \$59,220
AIR FORCE		U.S. BORDER PATROL	
LT. COLONEL	Leader of a flying squadron \$67,644	AGENT	\$21,947 to \$43,226*
CAPTAIN	Pilot in a flying squadron \$41,872 to \$50,278	F.A.A.	
		AIR MARSHAL	\$35,100 to \$80,800

*Enlisted pay is exempt from income tax **Some earn more
Data: U.S. Armed Services, U.S. Government Web sites



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Up Front

AFTER 9/11

WHERE ALL THOSE TRADERS WENT

FORCED OUT BY THE September 11 attacks, more than 30 finance and securities firms found themselves without trading floors. So executives had to get creative.



THE DISPLACED: 16,000 traders, researchers, salespeople, and support staff in more than 30 trading firms

THE REBUILDING: 1 to 2 years

THE COST: \$3.2 billion

Data: TowerGroup estimates

They spread out and set up temporary trading all over: in a warehouse, in New Jersey, at a college, and in offices of a defunct dot-com.

Oil, metals, and agricultural-products trader Refco sent 30 people to Baruch College on Manhattan's East Side. The school had a mock trading floor for MBA students, with live data feeds, T1 Internet connections, and 40

computer stations. When Refco Vice-President Jeff Bauml approached his alma mater about lending the space to his traders, Baruch transformed the "virtual" floor into a real one within 48 hours. "If I were building a trading room today, I would model it after Baruch's," says Bauml. Refco stayed for three weeks before relocating to a vacant Seventh Avenue space that until recently belonged to a dot-com.

The New York Board of Trade went to a converted warehouse in Queens to trade cotton, coffee, sugar, and cocoa. "It's very different from Wall Street, but everyone is making do," says a spokesman, who predicts being permanently back in Manhattan within a year.

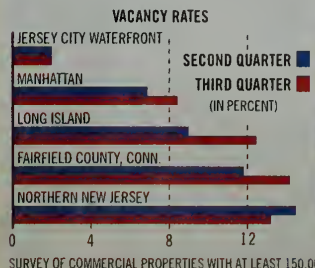
Others are squeezing into tighter spaces. Investment banker Sandler O'Neill, which lost 66 of 148 New York employees in the attacks, set up makeshift stock and bond trading in its Midtown office—in areas that "would comfortably suit one or two people and are now uncomfortably fitting five or six," says Terry Maltese, head of asset management. Yet even the most crowded of traders seem happy just to be up and running—and alive.

Julia Cosgrove

THE BIG PICTURE

NEW YORK OFFICE SPACE: VACANCIES RISING

Despite the office space lost in the World Trade Center, vacancy rates for office buildings in the New York region are mostly climbing. The exception is New Jersey, which has captured refugees from Wall Street.



Data: Grubb & Ellis

DRAWN & QUARTERED



HOME ENTERTAINMENT

A BOFFO SEASON FOR VIDEO GAMES?



WITH PEOPLE HUNKERING down in the wake of the terrorist attacks, they're spending more time at home—and on home-leisure activities. Already, analysts estimate that home video-game sales will surge 23% this year, to \$6.9 billion, the strongest growth in three years. That strength comes, in part, from the hype surrounding the much-anticipated mid-November launches of two new game consoles, Nintendo's GameCube and Microsoft's Xbox.

If bio-scares and the war against the Taliban continue, sales could rocket even higher. "People are looking for safe entertainment and a way to escape reality," says Scott McDaniel, vice-president for marketing at Sony Online Entertainment, which is pulling in revenues of \$4 million a month in subscriptions to its Web-based game EverQuest.



If you're assuming there's a mass aversion to violence that will slam video games, think again. The industry shelved or altered little material after the attacks. That's because violent games, rather than "M" (mature) or "R" (restricted) games, accounted for only 7% of the industry's annual sales. Publishers are targeting older audiences, not just 15-year-olds. Today's average gamer is 28. Kent Joseph, a computer programmer from Charlotte, N.C., is 28. And they tend to buy sports titles. Joseph recently ordered Sony's NHL 2002 and Madden 2002, and the new GameCube. His bill: more than \$500. And he's not done yet. "I intend to put a lot more money into games this winter," he says.

The industry hasn't been around long enough to have endured a sustained economic downturn before, so what will happen beyond the holiday season is something of a mystery. Yet as we seek ways to escape, look for home videogames to help do it.

Arlene Weintraub

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How fast can you plug me in?



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KICKING THE OIL HABIT

Many geologists think the world is approaching "Hubbert's Peak," the point at which global oil output begins to fall, bringing even greater risk of economic and political dislocation ("What to do about oil," News: Analysis & Commentary, Oct. 29). Greater energy efficiency will buy time to diversify the U.S. energy portfolio with hydrogen and other petroleum alternatives.

Jim DiPesa
 Republicans for
 Environmental Protection
 Kent, Wash.

Contrary to popular belief, Americans do not have the highest standard of living—because we spend so much time stuck in thousands of miles of traffic congestion. Americans are also dying at a high rate in car accidents—42,000 deaths per year.

Europeans spend much more time enjoying life: They have invested heavily in high-quality train systems that move people quickly, safely, and efficiently. Instead of pouring billions of dollars into expanding highways and trying to save a dying airline industry, let's put that same money into changing our great country for the better with a new, nationwide high-speed train network like the Eurostar. It will make all our lives so much better.

Andy Kunz
 Miami Beach

Simply shifting U.S. oil dependence from the Middle East to somewhere in Eastern Europe is the wrong answer.

Political upheavals will occur in that region as well, again forcing the involvement of the U.S. As a nation, we must embark on an effort to convert to a hydrogen-based economy. For the short term, we must focus on wind power and improvements in oil-efficiency technology. We are bringing in wind power in large-scale projects at 4¢ per kilowatt hour in the Northwest. What energy investment is smarter than that? Oil-efficiency technology may provide 50 times the projected yield of oil drilling in the Arctic.

Charlie Knudsen
 Greenbank, Wash.

The world's most abundant element by far is hydrogen. It's clean and energy-efficient, but there seems to be very little mention in media about how we can turn hydrogen into our main source of energy. By seeking ways to develop

energy from hydrogen—even if the process were to take 10 to 20 years—we could further reduce our dependence on the Middle East. That would make our country held less

responsible by those who hate us while the same time making the U.S. a safe place for future generations.

Jason William Dornhoff
 Boston

TURNING GAP AROUND IS A TEAM EFFORT

"Gap: Missing that ol' Mickey mag" (The Corporation, Oct. 29) degenerated into an inappropriate personal attack on Gap CEO Mickey Drexler, based largely on unattributed anecdotes and



WHAT TO DO ABOUT OIL
 Here's how the U.S. can reduce its dependence on petroleum made

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Readers Report

CORRECTIONS & CLARIFICATIONS

Returns for the several ProFunds mutual funds were misreported on the Figures of the Week pages in the Oct. 29, Nov. 5, and Nov. 12 issues. The correct figures for the Nov. 12 issue are as follows: ProFunds Ultra OTC, 30.12%, and ProFunds UltraBull, 0.6%, for four-week total returns. The 52-week return for ProFunds UltraBull was -51.2%. The figures for mutual-fund leaders and laggards for the three issues mentioned have been corrected in the archives on BusinessWeek Online.

innuendos from former employees. The caricature was hardly representative.

Despite the time Mickey and I, together with other members of our team, spent with the reporter, the story gave scant attention to the openness and candor of Mickey and other executives in admitting our mistakes and articulating what we're doing to move forward. As CEO, Mickey has stated that he is, of course, ultimately responsible for our performance. But he doesn't work alone. Our senior management group shares that responsibility and the determination

to return Gap to its normal high standards of performance.

John Lillie
Vice-Chairman
Gap Inc.
San Francisco

DON'T LOSE SIGHT OF THE REAL QWEST

Some would have you believe that "On the firing line at Qwest" (Information Technology, Oct. 29) is about old-fashioned analysis and its triumph over shady management. The story talks of "good research" and "sharp-penciled analysis." Aren't [Morgan Stanley Dean Witter & Co. analysts Jeffrey Camp and Simon Flannery] these the guys who brought you recommendations [including] WorldCom, Broadwing, Akamai Technologies, Loudcloud, and Exodus Communications? They brought to the fore some material issues, but in my opinion, they have a lot of work to do to regain their credibility.

Bill Dierker
Columbus, Ohio

As a Qwest shareholder, I am deeply disappointed by the stock's performance, but I am very pleased that these ana-

lysts, instead of being promoters, asking the hard questions and unearring aggressive accounting methods, suspect the objective, critical view of Qwest's reporting practices is still relatively rare on Wall Street. I sincerely hope [these] actions represent the future of the Wall Street analyst community.

Erik L. Johanson
West Hartford, Conn.

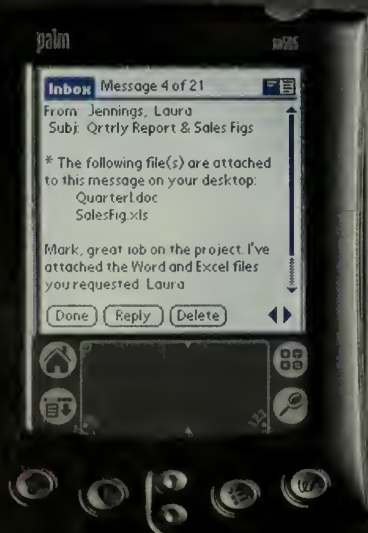
Qwest CEO Joseph Nacchio seems to have exercised a tremendous number of stock options at \$5.50 and sold them in the high-\$30-to-low-\$40 range. I thought options were to reward executives for improving the company thereby benefiting the stockholders. I suggest all stockholders check the way these rewards are being used.

Harry B. Harkness
Harkers Island, N.C.

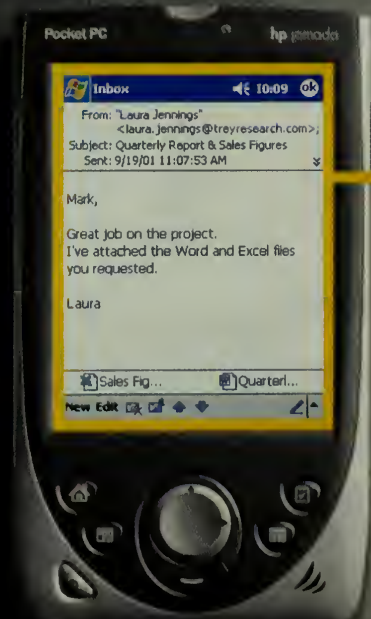
THE ODDS AREN'T IN THIS TRAVELER'S FAVOR

Unlike other publications that have been publishing editorials rationalizing why it's O.K. to profile Arab-looking people while claiming it's not the same as "driving while black," *BusinessWeek*

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Windows Powered



Joan O'C. Hamilton called what's pening to people of South Asian descent what it is: plain bigotry ("A shad-in the valley," e.biz, Oct. 29). In the past month, U.S. passport in d, I have made the dreaded trip to airport several times. I still mar-at ticket agents telling me with a tight face: "Random checks may be ducted." I have played the lottery 10 years, and my number has never n "randomly" selected. Wouldn't you w my luck with the airport search en traveling alone: 100%!

Richard Ramlall
Reston, Va.

OVER APPROACH TERRORISM INSURANCE

Rather than continuing to cut "aid" to ntries such as Egypt, Israel, and istan (among others), in hopes that y will safeguard U.S. interests, we uld have them put their money ere their mouth is—as shareholders a federal entity set up to provide orism reinsurance to U.S. insurers ive insurers a break but not a free y." News: Analysis & Commentary, . 29). The federal government would d the only voting share—thereby trolling receipts and disbursements—le the other (nonvoting) shareholders

would receive quarterly dividends based on the market-based success of this terrorism reinsurance. As a result, these shareholders would have an interest in preventing terrorism in the U.S.

John Gatlin
Washington

SEPTEMBER 11: THE SOUL-SEARCHING CONTINUES

Two letters in Readers Report of Oct. 22 (relating to "The roots of resentment," Special Report, Oct. 1) suggest that the U.S. has been generous in its treatment of poor countries. Not so. Data available from the Foreign Policy Assn. show that U.S. aid to undeveloped countries has been a smaller percentage of U.S. national income than from any of the other developed countries—many of them much smaller. In view of our high per-capita income, it should be the other way around.

Jetson E. Lincoln
Montclair, N.J.



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EMPIRE
A Tale of Obsession, Betrayal, and the Battle for an American Icon
 Mitchell Pacelle
 \$34.49 • \$27.95

TREET FIGHT OR A SKYSCRAPER

Real estate can be a sleazy business—as many reporters who cover it will attest. And it seems to get bigger the building and the city, the sleazier it gets. This explains the plethora of family feuds, legal wrangling, political posturing, financial high jinks, and lost fortunes that are so expertly and enjoyably chronicled in *Empire: A Tale of Obsession, Betrayal, and the Battle for an American Icon*, a biography of the Empire State Building by *Wall Street Journal* reporter Mitchell Pacelle.

The book appears at a time of morbid fascination with big buildings, following the attack that leveled the World Trade Center. Giants such as the Twin Towers or the Empire State are not attractive just to terrorists, however. Their size, visibility, and prestige make them targets also for some of the most ruthless, greed-driven business people in the world. If Pacelle's prose is not always rise to the heights of the skyscraper whose history it describes, the book nonetheless manages to bring alive in great detail the vivid characters who built it, bought it, and tried for its control. In doing so, *Empire* also gives the reader an overview of one of the greatest urban generators of wealth: real estate. What oil is to Texas, real estate is to New York, and New York's real estate pooh-bahs, such as Donald Trump, Leona Helmsley, and Peter Malkin, all play a part in the story of the Empire State Building.

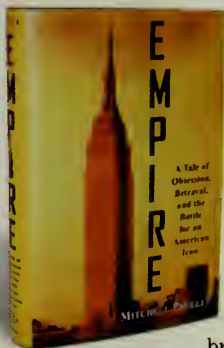
Readers may feel they already know enough about some of these people. We've all heard how the tabloids dubbed Leona Helmsley the "Queen of Mean," that at her 1989 trial for tax evasion, her housekeeper quoted her as saying that paying taxes was just for the little people." It's common knowledge that Donald Trump has an outsize and outlandish ideas: He considered making the upper floors of the Empire State into luxury condos. So, wisely,

Pacelle shapes his story around a less well-known figure: Hideki Yokoi, a Japanese businessman with a penchant for collecting trophy properties, including French châteaux, English castles, and, of course, the Empire State Building. According to the author, Yokoi used a front man to buy the property from Prudential Insurance Co. in 1991 for only \$42 million. His illegitimate daughter, Kiiko Nakahara, would later say that he bought it for her. The low price was the result of a 1961 decision by Prudential to lease the entire building to a partnership—ultimately controlled by Harry and Leona Helmsley and Peter Malkin—for a period of 114 years. Annual rent for that lease is, currently, only \$1.9 million. Unencumbered by that lease, the building could be worth \$1 billion.

Yokoi's fortunes worsened in the early 1990s, however, when the Japanese economic bubble burst. That resulted in an alliance with Trump, who Yokoi hoped would be able to raise cash from the Empire State by devising a way to break the lease—and thus save

Yokoi's remaining properties in Japan and Europe.

But the purchase is only the beginning of what turns into a lengthy, globe-spanning soap opera. Harry Helmsley dies, leaving his controlling interest in the Empire State lease to Leona, who proceeds to fight with Peter Malkin about almost everything—and to snub him by not inviting him to Harry's funeral. Yokoi is convicted of negligent homicide for a fire at a hotel he owned in Tokyo and is consigned to a Japanese prison, where he suffers a stroke. Yokoi's most trusted business aide was daughter Kiiko, who, without his explicit consent, allegedly transfers the Empire State and several French châteaux to entities controlled by her and her tough-talking French investment-banker husband. In due course, French authorities begin to question the



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transfers of the French properties. A back in New York, a disaffected of worker begins generating media coverage of tales of muggings and vermin infestations in the Empire State—which plays into Trump's plan to break the lease. Then, for \$6,000 a month a piece of the action, this Paris art student related to Yokoi decides to....

Well, you get the idea. Real estate can be seamy. And the battle goes on. Although many legal issues have been settled, some principals are still making news. Leona Helmsley, for instance, was recently reported to be hot and heavy with a Florida doctor who even one, except her it seems, knew was going. The poor lady was crushed.

While Pacelle's narrative is engrossing, one is left with the big question: What does it all mean? Somehow

Stories of muggings and vermin at the Empire State played into Trump's plan to break the lease

amid the stories about extradited Frenchmen and foul-mouthed real estate heiresses lurks a larger story: how one of New York's premier industries works—and how it is evolving. But Pacelle doesn't quite get to it.

By the 1950s, Helmsley and his partners had revolutionized the real estate business by making the syndication of large properties standard practice. But ownership remained dominated by a few large family dynasties. Pacelle's story seems to mark the decline of that way of doing business—as does the emergence of real estate investment trusts, which are public rather than private ownership vehicles. The old ways are dying, but the new ones have not fully taken hold yet. Writes Pacelle: "In many ways... the real estate sector remains world unto itself, as far from the cutting edge as Harry Helmsley was from Silicon Valley."

It would have been lovely if the author had considered what refusing to change means for the industry and New York. Even with that omission, however, *Empire* is a finely wrought narrative that embodies the style—and hysteria—of New York real estate.

BY ROBERT McNAMARA

Associate Editor McNamara writes about New York.

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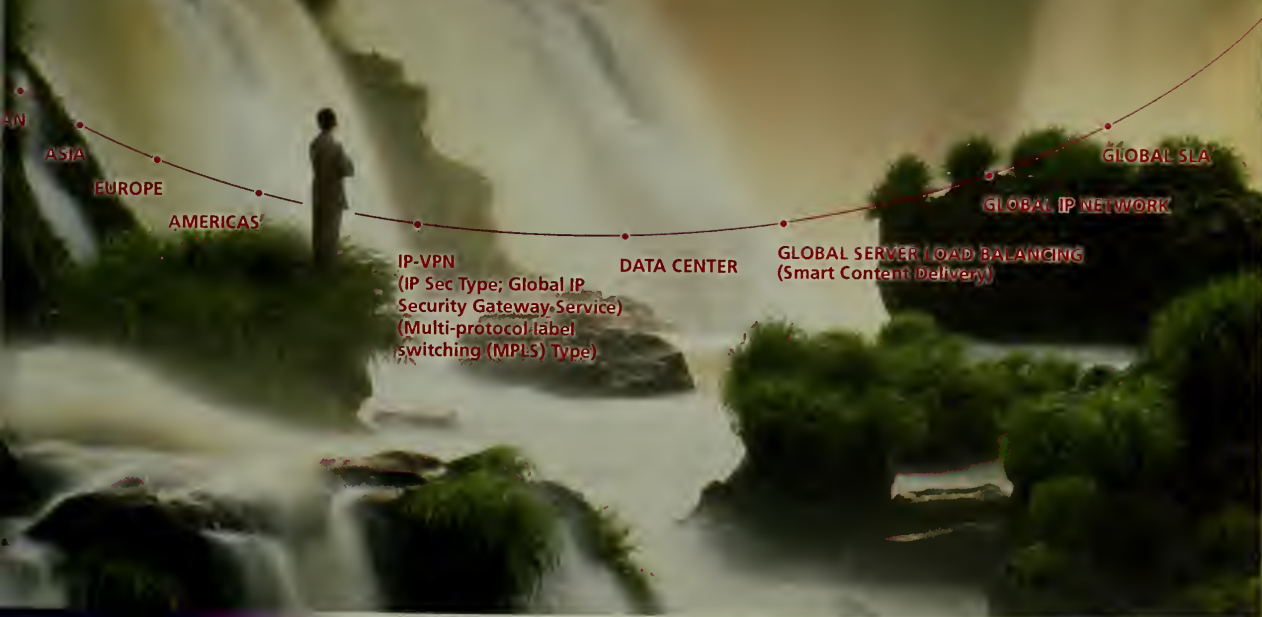
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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

A LIGHT LAPTOP THAT'S FULLY LOADED



Toshiba's Portégé 4000 may be the first compact notebook that doesn't skimp on features

For about as long as there have been notebook computers, there have been ultra-compact versions designed for buyers who could pay more for the ultimate in mobility and who were prepared to sacrifice considerable function. The era of compromise may be over. Toshiba's new Portégé 4000 is not the thinnest or lightest laptop around, but it squeezes just about everything you might want in a portable PC into an amazingly compact package.

The first sacrifice made in compact designs has traditionally been an internal CD or DVD drive. The solutions for those times when you must have at least a CD-ROM have been discouraging: external drives connected by awkward cables, or snap-on bases called "slices" that left the unit bigger and heavier than it would have been with built-in drives.

Not so with the 4.3-lb. Portégé 4000. It's smaller and about a half-pound lighter than "thin and light" workhorses such as the IBM ThinkPad T23 or the Dell Latitude C600. But like its bigger competitors, the Portégé 4000 offers an internal bay that can take a variety of components. A CD-ROM drive is standard, but options include a combo CD recorder/DVD drive, a second battery, or a second hard drive. In addition, the Portégé 4000 features a slot for SD memory, a postage-stamp-size card that can hold up to 64 MB. The card can be shared with a number of Palm and PocketPC models and some digital cameras.

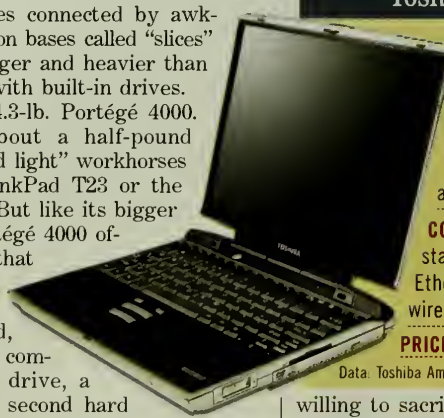
The Portégé 4000 is also extremely rich in communications options. Like almost all current laptops, it comes with an internal modem and Ethernet connection, but it also offers two integrated wireless hardware options. There's "Wi-Fi" (also known as 802.11b) for connecting to wireless local networks, for which you pay \$100 for an Agere version or \$150 for Cisco Systems'. And there's Bluetooth, a new short-range wireless standard designed to replace cables when you connect to a personal digital assistant, printer, or other accessory. It costs \$100. Bluetooth is mostly a curiosity at the moment, but it should turn up in more accessories as costs come down.

With two USB connectors, slots for two PC cards, an infrared port, and an external video connector, there's not much you could add. If you want an old-fashioned serial or parallel port,

you'll need a \$199 port replicator that also serves as a dock for desktop use. An external USB floppy drive is also an option.

Versatile as the new Portégé 4000 is, Toshiba has made some compromises—one of which is display size. Compared with bigger IBM and Dell Computer models, which boast 14.1-in. displays with resolutions up to 1400x1050 pixels, Toshiba's 12.1-in. display looks a little cramped. For an engineer working on technical drawings or a financial executive using large spreadsheets, it may not be adequate. But for typical laptop tasks—reading e-mail, editing memos, and Web browsing—the Toshiba screen does fine. The computer also fits well on an airplane tray table. The small display and a relatively slow (but more than adequate) 750-MHz processor help the Portégé 4000 get a decent three-hour battery life. With about an inch less width than a standard laptop, the Portégé's keyboard is a bit cramped, but subtle layout changes make it far better than earlier Toshiba efforts.

If even this strikes you as too big and you a



Uncompromising Mobility: Toshiba's Portégé 4000

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Data: Toshiba America Information Systems

willing to sacrifice a lot for mobility, you might consider the Sharp PC-UM10. This 2.9-lb. laptop, just 0.8 in. thick, represents a style popular in Japan, and Sharp hopes it will give the company a beachhead in the U.S. market. The UM10's unique feature is a keyboard that pops up a bit as the lid is opened. The resulting three millimeters of vertical travel, the same as on standard laptops, makes for a much better typing feel. Unfortunately, the layout of the keyboard leaves much to be desired. A tiny right-shift key and arrow keys that are not offset from the main keyboard make typing difficult.

The PC-UM10 sells for \$1,999, but the optional \$279 external CD-ROM is mandatory unless you can load whatever software you need over a network. Unlike most laptops, you can't add memory to the Sharp—and the built-in 128 MB is just adequate. A 256-MB model costs an extra \$100, which would be money well spent.

The Sharp is obviously a niche product, but the Portégé 4000 may help redefine the mainstream notebook for the mobile executive. This is a case where smaller truly is better.

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BY ROBERT KUTTNER

ENERGY CONSERVATION: AN IDEA WHOSE TIME HAS COME AGAIN



USE LESS:
As global oil reserves dwindle, U.S. energy policy should focus on cutting consumption and finding renewable sources of power

Gasoline prices are down, largely because of the recession, but enjoy the bargain while you can. The next major economic shock could well be an energy crisis. Some 21% of U.S. oil consumption comes from the Middle East. If the war in Afghanistan drags on or widens, the Middle East could become more unstable and with it the short-run supply of oil. The Saudis have been reluctant to cooperate fully with U.S. intelligence, in part for fear of terrorist reprisals against their pipelines and refineries. Energy production and distribution are also vulnerable to the risk of further terrorist attacks at home. This is a crisis the country could face in the months ahead.

But a far more serious energy problem looms just beyond the horizon—the dwindling of worldwide oil reserves. From 1980 to 1990, new discoveries increased world petroleum reserves by over 60%. From 1990 to 2000, however, reserves increased by just 4%. A new book, *Hubbert's Peak: The Impending World Oil Shortage*, by the oil geologist Kenneth S. Deffeyes, calculates that world oil production will peak sometime in this decade and then, slowly and irreversibly, decline.

Deffeyes is no tree-hugger. At Shell Oil's research facilities in the 1960s, he worked with the famed geologist M. King Hubbert, the man who correctly forecast, in 1956, that U.S. domestic oil production would peak in the early 1970s. Today, the U.S. produces just 38% of the oil it consumes. Deffeyes, using Hubbert's methodology, shows that the trajectory of world reserves is closely following the pattern of U.S. discovery and depletion, with just a few decades' lag. Drilling deeper, in more remote locations, and with more elaborate technologies won't tap reserves that don't exist.

Short-term events and long-term prospects both cry out for a very different energy policy from the one being proposed by the Bush Administration: a policy that emphasizes conservation and a shift to renewable sources of power. Unfortunately, the Bush Administration's energy policy stresses new drilling rather than technology and conservation. The entire reserves in the Arctic National Wildlife Refuge, where Bush wants to drill, would yield only about 2% of U.S. annual consumption at its peak output in 2027, and hardly make a dent in total energy needs.

A quarter of a century ago, during the first U.S. energy crisis, a visionary named Amory Lovins burst upon the national scene with an

article in *Foreign Affairs*, making the brilliantly simple observation that the cheapest source of "new" energy is to use less of it. If you consume one less barrel of oil, that's one less barrel you need to drill for. (Not surprisingly, oil companies were less than enthusiastic.) Lovins' other big idea was that "soft" energy—renewable and decentralized sources such as solar power—was both more reliable and less damaging to the natural environment than extracted carbon-based fuels.

Lovins hasn't gone away. Today, his Rocky Mountain Institute, based in Snowmass, Colorado, consults for large corporations that share his insight that using less energy is the most efficient way of saving on energy bills. Lovins also invokes the current war emergency to promote decentralized and renewable modes of power, as well as the need to develop more energy-efficient technologies to stretch the supply of oil. Toyota Motor Corp.'s midsize Prius car already offers 48 miles per gallon, using a self-charging hybrid gas-electric engine. Lovins is developing a variation of Prius technology that gets 100 mpg.

CRYING WOLF? The Administration likewise had little interest in the global-warming problem. But reducing worldwide oil consumption for the sake of the environment also would reduce dependence on imported oil and give scientists more time to develop practical alternatives before the oil ran out.

America made a false start at pursuing a different energy policy in the mid-1970s, using regulations, subsidies, and tax incentives to promote conservation and alternative fuels. But the energy crisis of that era was the artificial result of OPEC's temporary manipulation of oil prices. When oil prices receded after the 1980-81 recession, America returned to its love affair with gas-guzzling cars. Conservationists seemed like the boy who cried wolf.

Now, however, we face a real wolf. The world is truly running out of oil, and we face a political adversary far more serious than OPEC. The oil industry has never had a better friend than the Bush Administration. But George W. Bush needs to remember that he is now America's commander-in-chief, not Big Oil's. Policies that seem utopian and improbable suddenly look like common sense when national security demands them.

America's energy policy needs to tilt away from oil and in favor of conservation, new technology, and domestic renewables. The time to act is now, before the next wave of gas line and rationing is upon us.

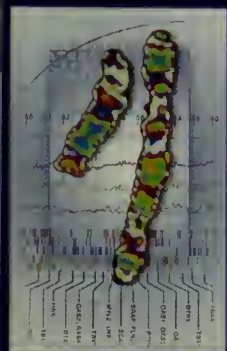
Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.

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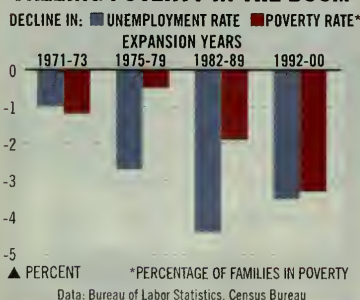
EDITED BY MICHAEL J. MANDEL

A GOSSAMER-THIN SAFETY NET

So recession packs a double wallop

Among the signal benefits of the long economic expansion of the 1990s was a surprisingly large plunge in the nation's poverty rate. The percentage of poor families fell from 11.9% in 1992 to 8.6% in 2000 (chart). That's a far bigger drop in poverty than seen in the previous several expansions. For exam-

FALLING POVERTY IN THE BOOM



ple, the sharp drop in unemployment in the 1980s only nudged the poverty rate down to 10.3% in 1989.

What was different about the 1990s was that the tight labor markets helped drive up real wages for unskilled jobs. Moreover, the extended period of below-6% unemployment encouraged businesses to hire and train poor workers they would otherwise have passed over. And the welfare reforms of the 1990s forced former recipients to get jobs just when there were plenty to fill.

But as quickly as poverty dropped in the 1990s, it could rise just as dramatically in the next few years, argues Richard Freeman, a leading labor economist at Harvard University. Many Wall Street economists are predicting that the jobless rate could top 6.5% in coming months. Freeman estimates that because the U.S. has scaled back its safety net, unemployment of 6% or more will quickly send the family poverty rate back into double-digit territory. "I think we will see a rise in the poverty rate," says Freeman. "And I think it will be bigger than an historically expected increase, because we have undone a lot of the welfare underpinnings."

The family poverty rate could even rise above the 12% level of the previous two recessions. The vicious squeeze on

state budgets after September 11 is limiting the ability of policymakers to respond to the growing needs of their poorest constituents. The crunch will come when welfare mothers who have proven their willingness to work lose their jobs. One sign that things are getting tougher: The jobless rate for black women jumped from 6.9% in August to 8.9% in October, the highest level since June, 1997. "The extent to which poverty will increase depends on how fast we change policies," says Freeman. "When we see women and children about to go on the streets, policymakers will have to do something." John F. Kennedy remarked that a rising tide lifts all boats. But without countervailing efforts by policymakers, the ebb of recession can sink many boats as well.

By Christopher Farrell

THE BAD RAP ON IPOs

They do as well as other companies

Personal finance magazines regularly warn against buying shares in companies that have just gone public. Critics of initial public offerings say their prices run up too high in the first day or so of trading, so anyone who buys in after that will be stuck with an underperforming investment. But how true is that?

A new study by two Harvard Business School professors offers some encouraging words for potential investors in IPOs. In a National Bureau of Economic Research working paper, Paul A. Gompers and Josh Lerner take a long view of IPOs by studying the performance of more than 3,600 companies that went public from 1935 to 1972—an era that has been largely ignored because it precedes the advent of the Nasdaq Stock Market, and information about the period is harder to obtain. They then compared the companies' stock market performance both with the overall market and with the performance of longer-established companies that were otherwise similar.

Their conclusion: IPO companies performed no better and no worse than the others. Gompers and Lerner don't comment on the debate over whether IPOs have underperformed during the Nasdaq era. But they say that if indeed they have, it might be more of a "historical accident" than evidence of some enduring investing anomaly.

By Peter Coy

EUROPE'S SCANT INFO-TECH PAYOFF

Too much regulation curbed gain

In the second half of the 1990s, U.S. productivity growth accelerated 2.4% annually, while European productivity growth dropped to 1.2%—half former growth rate. In part, this difference came from the explosive U.S. investment in information technology. But a study from the Conference Board, which carefully reconciled the productivity and investment measures of different countries to ensure comparability, confirms what many economists had suspected: That much of the U.S. productivity advantage came from a more competitive regulatory and market environment, rather than simply a higher level of investment in IT.

The study examined European industries that were heavy users of such as finance and wholesale trade. Based on new data gathered by the University of Groningen in the Netherlands, it found that the European industries contributed less than half the productivity gains of their American counterparts between 1995 and 1999.

It's not that Europeans can't get the technology. "IT products are available internationally, and the prices are similar," says Robert H. McGuckin, director of economic research at the Conference Board and co-author of the report with Bart van Ark of the University of Groningen. The real issue for Europe, McGuckin says, is the need to deregulate industries from banking to telecommunications to transportation, all of which are big users of IT.

All told, industries that were heavy users of IT contributed 1.4 percentage points to U.S. productivity growth in this period (chart).

The comparable industries contributed only 0.5 point to productivity growth in Britain and Germany, and Italy and France showed even smaller gains.

But McGuckin is optimistic: Now that Europe has a single currency, it should be able to deregulate over the next few years and catch up to U.S. productivity growth.

By Margaret Poppo

THE U.S. PRODUCTIVITY ADVANTAGE

CONTRIBUTION OF IT-INTENSIVE INDUSTRIES TO ANNUAL PRODUCTIVITY GROWTH 1995-99



THE BAD NEWS ON UNEMPLOYMENT WILL ONLY GET WORSE

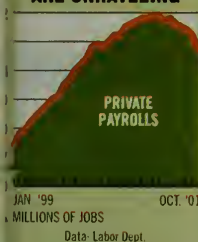
Companies will rely on productivity, not new jobs, to make gains next year

U.S. ECONOMY

About this time last year, people were asking: How low will the unemployment rate go? Now, after shrinking to a decade-low of 3.9% in September, 2000, the jobless rate's half-point surge last month, to 5.4%, in the wake of the September 11 terrorist attacks is provoking just the opposite question: How high will it go?

The consensus view is that unemployment will peak about 6% by around the middle of next year, assuming the recession is a relatively mild one. However, some economists are beginning to think a 6% peak might be too optimistic, even in a mild downturn. Worse still, once the unemployment rate peaks, it is likely to remain at that level for most, if not all, of 2002.

THE LABOR MARKETS ARE UNRAVELING



st the past year. Every increase of a tenth of a percentage point above 6% would add about another 100,000 to the jobless rolls.

The Federal Reserve wants to cap that rise. On Nov. 1, the Fed went for a half-point cut in interest rates, instead of a quarter-point, citing "heightened uncertainty and a deterioration in business conditions both here and abroad." The Fed dropped the overnight federal funds rate to a 40-year low of 2% and the discount rate to 4%, and its statement left the door wide open for further moves. However, policymakers are likely to go back to quarter-point cuts from now on, given that reductions this year now total a huge 4.5 points.

MORE CUTS WILL PROBABLY BE NEEDED

to turn around the economy and the labor markets. The Labor Dept.'s jobs data show that the unemployment rate's jumped nearly a full percentage point in only four months, and monthly payrolls plunged 415,000 in October. Private payrolls have been shrinking since last March (chart), indicating only part of the October layoffs were related to the September 11 attacks.

Other data point to a sharp deterioration in job prospects. Help-wanted advertising in September newspapers hit an 18-year low, and the weekly level of new claims for jobless benefits is consistent with monthly payroll losses in the 200,000 to 250,000 range. Some of the labor-market weakness reflects the initial shock of the September 11 events. But two months later, claims show no sign of drifting lower as yet.

Of course, rising jobless claims are typical in a recession, but a top worry in the outlook is how next year's economic performance will play out in the labor markets. Mild recessions usually generate moderate recoveries. So even though real gross domestic product is expected to rise next year, it may not grow fast enough to lift payrolls quickly.

More important, one key downside of the New Economy is that a high-productivity economy requires strong growth in order to utilize fully all available labor and machines. The U.S. appears able to maintain a growth rate of 3% or more without worrying about rising inflation. That also means the U.S. must grow at least 3% just to keep the unemployment rate stable. And it will have to grow considerably quicker than that pace in order to bring the jobless rate down.

PRODUCTIVITY HAS HELD UP

remarkably well in this recession. Despite the third-quarter drop in real GDP, output per hour last quarter rose at a sturdy 2.7% annual rate from the second quarter. During the past year, productivity has grown 1.9%, even though real GDP increased only 0.8% (chart). Companies responded to weaker demand by cutting back hours and jobs, leading to the increase in the jobless rate.

Moreover, productivity may well rise again in the fourth quarter. Hours worked began this quarter nearly 4% below their third-quarter average, measured at an annual rate of decline, about a percentage point faster than they fell in the third quarter. If, for example, real GDP contracts 2% this quarter—as many economists expect—then productivity would grow 2%.

By the end of this year, the economy's yearly growth rate will have slowed from more than 5% to less than zero, a swing of some 5.5 percentage points. But the

PRODUCTIVITY HOLDS UP SURPRISINGLY WELL



pace of productivity will likely have slipped by only half that much. In the past, an economic slowdown of the same magnitude would have generated a much sharper drop-off in productivity growth. And productivity is set to pick up as the economy recovers.

This strongly suggests that, although some of the late 1990s productivity surge was transitory, the economy is also retaining some of the gains. The Fed noted in its Nov. 6 rate statement that, while the shift in resources to enhance security after September 11 may restrain productivity advances for a while, "the long-term prospects for productivity growth and the economy remain favorable," and they will reassert themselves.

THE PROBLEM FOR NEXT YEAR is that businesses desperate to rebuild their profit margins will concentrate on lifting productivity gains rather than hiring new workers. The same thing happened after the 1990-91 recession, in the so-called jobless recovery. The unemployment rate rose a full percentage point during the year following the end of the recession.

Cost-cutting efforts by businesses are starting to show up in the form of shorter hours, less overtime, and slower wage growth. In October, the workweek shrank almost a half-hour from a year earlier (chart). Factory overtime hit a nine-year low. Hourly pay for production workers barely rose from September. All those cutbacks mean slower income growth, a down-

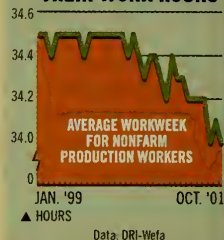
trend that will continue in coming months as the upsurge in the labor markets shifts back to companies and away from workers.

One plus from slack labor demand will be lower inflation next year. Add in cheaper energy and falling nonenergy import prices, and 2002 could mark the first year of outright price stability since the 1960s. That will boost household buying power and give the Fed considerable room to nudge interest rates even lower.

Low inflation also explains much of the recent rally in the bond market. Clearly, some of the favorable reaction in long-dated Treasuries outside of the 30-year bond was overdone, a reaction to the government's elimination of its 30-year offering. But this year's drop in long-term rates is based on the sound fundamental of falling inflation expectations.

Of course, increased buying power due to lower rates and inflation won't do consumers much good if they don't have a job or if they are worried about losing the one they have. This will be the first New Economy recession, and while productivity growth is likely to hold up surprisingly well, those gains may well come at a heavy cost to workers.

COMPANIES CUT BACK THEIR WORK HOURS



MEXICO

CONGRESS FACES A TAXING TIME

Fiscal reform has been a top priority of President Vicente Fox since he took office a year ago. Although Congress is actively debating the issue, any real progress is unlikely this year, and inaction could be costly.

The economy has been in a recession since the first quarter, and the September 11 terrorist attacks on the U.S. will extend the slump into next year, sapping revenues, especially from the country's two key sources: oil exports

and tourism. Both foreign and local investors are bound to get increasingly nervous over the slow pace of the reform efforts, which could delay Mexico's long-awaited investment-grade credit

rating from Standard & Poor's.

So far, the peso and the bolsa remain surprisingly strong, but Congress is expected to pass only a watered-down version of fiscal reform by yearend, which may

pack less of a punch than S&P and investors would like to see. The problem is not simply raising more revenue to pay for health, education, infrastructure, and past debts. The litmus test for fiscal reform's success, says economist Gray Newman at

Morgan Stanley Dean Witter & Co., will be improved efficiency of tax collection and enforcement.

Mexico's tax base is exceptionally narrow. Taxes are only 11% of gross domestic product, com-

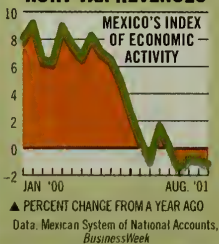
pared with 30% in the U.S. and 18% in Chile. Taxpayers hide behind a long list of tax-free goods and loopholes, including special tax treatment for some.

Extended weakness in Mexico's economy only heightens the urgency for fiscal action. Exports are already suffering from the new U.S. weakness, although imports are also falling due to rising unemployment and weakening domestic demand. That's keeping the trade deficit stable, but the declining price of oil is biting into government revenues, a third of which come from oil exports.

After growing 6.9% in 2000, the economy ground to a halt in the second quarter. Economists expect zero growth this year, with no meaningful recovery before the second half of 2002.

With Geri Smith in Mexico City

SLOWING GROWTH WILL HURT TAX REVENUES



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GUARDING AMERICA

Washington has yet to demonstrate that it has a handle on security

In Afghanistan, an intensified military campaign is under way, with signs pointing to a key push against the Taliban. But despite the incendiary images dominating TV screens, Americans these days seem more worried about the safety of Main Street, USA, than a distant drive on Mazar-e-Sharif.

Weeks of government warnings about new terrorist threats, a less-than-stellar Administration response to anthrax attacks, and signs of disorganization in the new Office of Homeland Security have taken a toll on public confidence. The result: rattled nerves and rising complaints about Washington's efforts to protect Americans from a reprise of September 11. In a Nov. 2-4 CNN/Gallup Poll, 7 out of 10 Americans said the

White House response to the internal terror threat was appropriate. But do folks feel safer? Not exactly. By roughly the same margin—74%—they are bracing for new attacks.

Why the pessimism? The Administration's monthlong drive to launch a sweeping homeland defense effort hasn't convinced many that the nation's basic infrastructure—from the mail system to airlines to key commercial facilities—is secure from future assaults by an educated, inventive, and diabolical enemy.

Reasons for anxiety aren't hard to find. The man who nearly boarded a United Airlines flight at Chicago O'Hare Airport with seven knives, a stun gun, and a can of Mace underscored a sense that the security effort is lagging. The false alarm a

few days earlier over threats to California's bridges had a similar effect.

In an open society, it's difficult to shield targets from Al Qaeda agents who don't mind dying. But "difficult" doesn't mean "impossible," and sources familiar with the Administration's anti-terror campaign say the machinery is moving slowly. The anthrax shock also sapped the attention of key aides such as former Pennsylvania Governor Tom Ridge,

HOMELAND DEFENSE

MOBILIZING FOR WAR AT HOME



radioactive spent fuel, a terrorist act could have catastrophic consequences. The Administration has instituted no-fly zones above plants, while companies are hiring more guards.

NUCLEAR POWER PLANTS

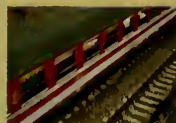
With 103 active private nuclear plants and 45,000 tons of



arenas, and office buildings are all vulnerable to attack. Authorities are responding with increased police patrols while private companies beef up their own security.

INFRASTRUCTURE

Oil and gas lines, bridges, roads, tunnels, ports, public



stations are now under surveillance, but tracks are open to attack. Legislation requiring better-trained airport-security workers will help, but rail remain largely unprotected.

TRANSPORTATION

Airport airplane security remain



BOSTON HARBOR
City and state infrastructure could pose a major security problem for the government

head of the Office of Homeland Security (page 37). In a Nov. 6 interview, Ridge conceded the bio-blitz consumed much of his first month on the job.

That attack was unforeseen, but other woes seem of the Administration's own making. Mindful of a revolt by House GOP hardliners, the White House has been enmeshed in a purely ideological battle over a Democratic-backed bill to federalize



airport security. But while Washington guesses, scares such as the O'Hare incident signal to the rest of the country that big holes remain. "Much of what has been done since September 11 is show rather than substance," asserts former American Airlines CEO Robert L. Cranwell. "There has got to be a comprehensive [security] plan administered by a single agency with absolute authority."

But that's precisely the kind of centralization the President wants to skirt. White House officials believe that in a decentralized New Economy, information is power, and targeted communication will produce the kind of security clampdown that's needed. So rather than an intensive, government-led mobilization, the Bush team intends to proceed in stages: Stage I entails heightened alerts on the

part of business, governors, and law-enforcement officials; Stage II requires massive consultation with CEOs and state leaders on a voluntary national action plan; Stage III, according to Ridge, would direct states found to be wanting on security plans or crisis response to meet a minimum "standard of preparedness."

But critics—among them execs—wonder if terrorism really can be fought in a decentralized way. Moreover, while many local communities and companies have stepped-up security (page 38), there is still little sense outside Washington that the federal government has an overall strategy to deter terrorism at home. Some see the need for more of a traditional wartime mobilization. Partha

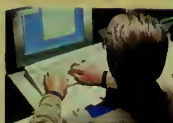
BIOTERRORISM



Washington is stockpiling vaccines and drugs and boosting

into new detection and treatments. Also, it is ramping up training for emergency response teams. Adequate vaccine supplies are at least a year away.

TELECOM & CYBERTERRORISM



Although terrorists use wireless and the Internet to plot attacks,

they could also target those networks. The Feds and telcos are creating plans to share backup networks. And they are strengthening computer firewalls and virus scanning.

POLICING THE BORDER



porous. The Administration is adding inspectors and patrol agents, going after foreign students who overstay their visas, and coordinating policies with Mexico and Canada.

America's 4,000-mile borders with Canada and Mexico remain

Ghosh, vice-president of Boston-based Adventis consulting group, urges a nationwide database to track immigrants, financial transactions, and even government-intercepted phone calls. The effort would be overseen by a powerful crisis manager modeled on Bernard Baruch, Woodrow Wilson's domestic war czar. Warns Joseph S. Nye Jr., Dean of Harvard's Kennedy School of Government: "There are certain things that can devolve to corporations, but as we saw with airline security, that doesn't always work."

Ridge, however, defends the bottom-up approach. "It's a very innovative, decentralized economy we have," he says. "There are already companies that have been thinking about potential problems and solutions."

STILL EARLY. One thing to keep in mind as the debate between the command-and-control advocates and New Federalists rages: It's still early in a mobilization that will take at least a year to unfold. And despite a halting start, headway is being made. Acting at the behest of Washington, governors are taking extraordinary measures to increase policing of potential targets, often working state troopers and National Guardsmen to the point of exhaustion. Also, there are signs the Administration's attempts to create informal brain trusts of anti-terror resources in industry and academia may be bearing fruit. As a result, many in the tech and scientific communities are going all-out on counterterror research with the blessing of Washington.

Case in point: William Ditto. The Georgia Institute of Technology biochemist isn't waiting for a government grant. He's at work on a sensor to detect anthrax and other deadly bioterror agents. He's relying on verbal assurances from state and federal officials that "they'll write us a blank check if we have a decent approach to this."

Drug companies are also making key contributions to the anti-terror drive. Bristol-Myers Squibb has offered to form a 25-person bioterrorism team to be used

by the government as it sees fit. Eli Lilly is asking the government to test a scientist's hunch that an existing anti-cancer drug might also be used to fight smallpox. And by early November, the Health & Human Services Dept. (HHS) is expected to cut a deal with drugmakers to produce 250 million doses of smallpox

D.A. Henderson, head of a new office HHS that coordinates planning for bioterror attacks. U.S. hospitals have little extra capacity, while health departments can't even keep up with routine disease outbreaks, he notes.

That's why the Administration will need to go beyond industry pow-

and commit big bucks to solve the problems. Key needs: improving communications among federal, state and local health authorities; stockpiling vaccines and drugs; honing responses to massive medical emergencies and funding new detection technologies. William Haseltine, CEO of Human Genome Sciences in Rockville, Md., advocates a 10-to-15 year Manhattan Project-like attempt to find vaccines and antidotes for nearly every conceivable germ.

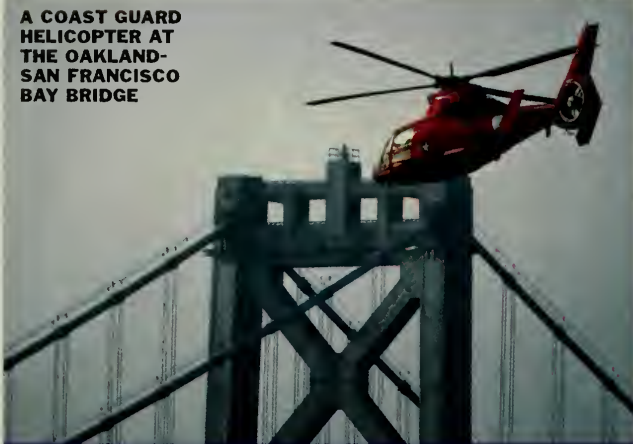
Another key concern: nuclear reactors that loom as inviting targets for kamikaze raids. A Nov. 6 report given to Ridge by representatives of the energy industry concluded "the bulk of our energy infrastructure is highly vulnerable to an attack," says Rob Housman, an industrial lawyer. Most vulnerable are the 103 commercial nuclear plants scattered around the country. The Nuclear Regulatory Commission has responded by ordering stepped-up patrols and a hurry-up review of plant security by yearend. And the Federal Aviation Administration has imposed a 12-mile no-fly zone around reactors.

At Exelon Corp.'s nuclear plants in Illinois and the Philadelphia area, the company has added a new ring of security personnel, inspecting packages, installed surveillance cameras and motion detectors, and run background checks on temporary workers. Still, says President and

co-CEO John Rowe: "We all know that this is a very vulnerable society. In many of our basic infrastructure areas, absolute protection is impossible."

How can nuclear power be made more secure? Storing spent fuel in permanent underground repository in Nevada would make sense, but the idea has long faced local opposition. Als-

A COAST GUARD HELICOPTER AT THE OAKLAND-SAN FRANCISCO BAY BRIDGE



DEFENDING CALIFORNIA

How one state is mobilizing

ANTI-TERRORISM CZAR

Governor Gray Davis named former FBI agent George V. Vinson as special adviser on state security.

POLICE OVERTIME

California Highway Patrol (CHP) officers are on 12-hour shifts, up from the usual 8 hours.

AIRPORTS

380 National Guard troops are assigned to patrol the state's 30 airports.

WATER & ELECTRICITY

CHP has put all 16 of its airplanes and 8 helicopters to work over the California aqueduct and electrical grid.

BRIDGES

National Guard troops and CHP are policing all major bridges. CHP has purchased \$100,000 worth of mobile cameras.

BIOTERROR

Hospital staffers have received training on anthrax and bomb threats. The University of California has set up a panel of biotech execs to work on developing antibioterrorism products.

CROPDUSTERS

California has more than any other state. For the first time, registration is now required with CHP in order to fly one.

vaccine—enough to inoculate virtually all Americans. "I don't think it is possible to drive a government contracting effort much faster than they did," says one top public health expert.

Still, there's an immense amount of work to be done on bioterror defenses. The key challenge is "strengthening the public health infrastructure," says Dr.

reactor housings will have to be hardened to protect them from air attack. Massachusetts Institute of Technology Professor Theodore A. Postol suggests a picket fence-like grid that in deflect the force of an aircraft.

TOPGAPS. Urban infrastructure—buildings, arenas, bridges, and the like—pose her concerns. For now, policing has been massively increased, but that leaves many localities struggling with the burden. West Virginia Governor Bob Wyse is ordered all hazardous material trucks be stopped and inspected on the border. “How long can you sustain this?” orders Wyse. Connecticut, with two nuclear facilities and a submarine base, has state police on a TI alert. “That means the entire force can show up at any location in an hour,” says Governor John Rowland. “Who the heck knows what terrorists are thinking?” Beleaguered state officials across the country say they now provide stopgap help, but Washington has to provide more funds.

Industry experts also feel more has to be done to combat cyber terrorism, since the Web is an inviting target. Even before September 11, 85% of companies surveyed in 2001 by the Computer Security Institute and the FBI reported computer breaches. That’s one reason Richard Clarke, special adviser to the president for cyberspace security, was knocking on Silicon Valley doors last month, picking the brains of execs at such outfits as Cisco Systems, Intel, Symantec, and Network Associates in hopes of finding solutions. “The barometers of Internet security are all in the red,” says Bill Conner, CEO of Dallas-based security outfit Entrust. On Nov. 8, his company was set to pitch the government on the building of secure Net links among federal, state, and local agencies via an encryption technology now in the test stage.

Other weak spots? Porous borders. Lax immigration enforcement. Spotty

intelligence-sharing among the CIA, FBI, and local cops. The list seems endless, which is one reason Ridge says that his new anti-terror agency will soon grow into a 100-person enterprise.

The hope, say business leaders, is that Congress and the White House respond to these enormous challenges with the kind of initial flexibility shown in the aftermath of September 11—a spirit almost erased now in the partisan squabbling that poisons the capital. Many hope this is another case where common sense will trump ideology. But as the Administration’s war against domestic terror slowly unfolds, there’s little evidence so far that those desires will turn into reality.

By Paul Magnusson, with Amy Borus and Laura Cohn in Washington, Amy Barrett in Philadelphia, Geoff Smith in Boston, Michael Arndt in Chicago, Wendy Zellner in Dallas, and bureau reports

HOMELAND DEFENSE

TOM RIDGE TALKS: A DISPATCH FROM THE HOME FRONT

On Nov. 6, former Pennsylvania Governor Tom Ridge, the new director of the Office of Homeland Security (OHS), talked with Washington Bureau Chief Lee Walczak and Correspondent Lorraine Woellert.

On getting the OHS up and running:

We have made good progress to enhance our ability to detect and prevent a potential attack and to respond if one occurs. But it is incremental, and we need to work daily to strengthen both capacities.

On mobilizing the business world:

I will look to the resourcefulness of business to help solve some of the problems we confront. The best way to employ the private sector is to think like the private sector does. They move quickly, in a very innovative, decentralized economy. Let me give you an example. Energy companies are potentially one of our greatest vulnerabilities. [People] in that sector recognize that, have some ideas on security, and are looking for a partnership with the federal government.

On the risk that a decentralized crisis response will leave gaps in security:

There are already companies that have been thinking about problems and solutions. My goal is to tap into those resources as quickly as possible. Our goal is to sit down with [key industries], identify vulnerabilities, [and] come up with an industry-led self-policing effort.... This is going to require all of us to challenge each other with ideas, to constantly look for best practices, and to rethink



ON MOBILIZING BUSINESS “The best way to employ the private sector is to think like the private sector does. They move quickly...”

everything we do in terms of security.

On the adequacy of allowing states to devise their own security plans:

States historically dealt with emergency preparedness independently. [Now] there’s a growing consensus [among governors] to assist

the federal government. We’re looking at communications, training, staffing. States are going to be partners. But there is also agreement among governors that there has to be a standard of preparedness [for] all 50 states.

On complaints that warnings of possible terrorist strikes have increased anxiety without providing useful guidance:

We issued two general alerts. The question is how we as a country deal with this heightened security, and we’re all struggling to find an answer. We’re not there yet. The only thing we know is that there are people committed to undermining our way of life, who turned a commercial

airplane into a missile, who turned a simple envelope into a weapon of terror. If we can take this sense of concern and channel it into being watchful and alert... we will get through this. But emotionally and psychologically, this nation hasn’t experienced this kind of uncertainty—ever.

WHEN THE OFFICE IS THE WAR ZONE

Employers strive to define their role in ensuring worker safety

When news of the threat to the Bay Area's bridges swept through San Francisco during that frenzied lunch hour on Nov. 1, executives at Bechtel Corp. found themselves contemplating a horrible scenario: What if a rush-hour explosion blew apart the Golden Gate Bridge, killing or injuring workers who were commuting to the company's downtown headquarters? In the next few hours, while the FBI and the governor's office were haggling over just how credible the threat was, Bechtel told its 3,000 West Coast workers that they could stay home the next day.

In the nerve-racked, post-September 11 world, Bechtel's decision is one of the thousands being made by companies that are raising a slew of new questions about corporate responsibility and liability. If an attack had taken place, could other businesses be held liable for insisting that their fearful workers show up? Would the work-from-home plan incite panic and set a precedent, compelling Bechtel to respond in the same, productivity-crippling fashion with each new scare? Moreover, does the war against terrorism mean companies not only have a higher duty to ensure a safe workplace but also a safe commute?

Such legal and ethical questions are swirling around the corridors of U.S. workplaces, as companies find themselves in a crucial new role: frontline defense in the war for homeland security. You can see it in the new ramparts at General Motors in Detroit, which are capable of deflecting truck bombs; in the \$75-an-hour bomb-sniffing Labrador retriever at Lehman

Brothers in New York; and at Coca-Cola's headquarters in Atlanta, where visitors can no longer wheel into the underground garage—instead, they must drive to an open-air parking lot a quarter-mile away, where guards search under their hood, trunk, and chassis.

"There's a sea change going on," says employment attorney Garry Mathiason, a partner at San Francisco-based employment law firm Littler Mendelson. "Workplaces are incredibly important as protection tools in this war."

EYES AND EARS. The uncertainties are forcing corporations to go to extraordinary lengths to create safe workplaces. Improving external security is only the beginning. Many labor lawyers say companies will also need to be more vigilant in monitoring their own ranks. Already, a higher legal standard for screening job applicants' and current workers' backgrounds has emerged—no more so than for the 770,000 workers whose jobs

take them behind airport security checkpoints. And until recently, many managers and co-workers have hesitated to report suspicious or dangerous employee behavior to the feds for fear they would risk civil suits.

Now, attorneys say the recently passed anti-terrorism bill gives businesses new immunity to ferret out and report employee behavior that may pose an immediate threat. As a result, many companies are adopting background checks and increasing the use of surveillance equipment and software that monitors e-mail and Internet use, according to Susan Potter Norton, a partner with Miami-based employment firm Allen Norton & Blue.

As if that weren't enough, companies are also having to school themselves in the role of psychological coun-

selor. Managers need to be attuned to the new anxiety in the workplace heading off morale problems, while at the same time rallying the troops to get work out the door. If they don't, productivity could suffer and their companies could face potential legal liability for not referring at-risk employees to counselors, says Bruce Blythe, the chief executive of Atlanta-based Crisis Management International. Companies are also implementing training to deal with the increase in workplace harassment against Arab Americans and Muslims.

Of course, building the corporate fortress is expensive. At investment banks, for example, the high costs of added security could lead to a 1% reduction in return on equity, says Morgan Stanley Dean Witter & Co. analyst Henry H. McVey.

With the country already in the midst of a recession, the added burden could not come at a worse time. But in the wake of September 11, corporate America has no other choice.

By Michelle Conlin with Emily Thornton in New York, Dean Fournier in Atlanta, and David Welch in Detroit

HOMELAND DEFENSE

PROTECTING THE WORKFORCE

EMPLOYER AS BIG BROTHER

The anti-terrorism bill gives new immunity from worker lawsuits, enabling companies to report behavior that could pose an immediate threat.

THE CORPORATE FORTRESS

Companies are securing ventilation ducts, installing mail censors, and using dogs to sniff out bombs.

CORPORATE PATERNALISM

Companies have to do more than protect executives from kidnapping. They also need to instruct on safe mail handling, draw up more effective evacuation plans, and help treat traumatized workers.

RELIGIOUS TOLERANCE TRAINING

With tensions running high, any company that fails to protect Muslim workers from harassment could face stiff legal and financial penalties.



ON GUARD: At the Sears Tower



GIULIANI, BLOOMBERG, AND PATAKI: *To keep business happy, speed will count*

ALL STREET

WHAT KIND OF DOWNTOWN DOES NEW YORK WANT?

Reaching a consensus may be the hardest part of rebuilding

The cleanup is well under way. Almost two months after the terrorist attacks, tons of debris have been cleared off, and damaged buildings near the leveled Twin Towers have reopened.

And now, after a neck-and-neck race, newly elected Mayor Michael R. Bloomberg's first and perhaps toughest decision is staring him in the face: what to do with the gaping hole at the bottom of Manhattan.

Bloomberg will be stepping into a mess, no doubt. But he won't be alone. After a slow start, New York Governor George Pataki and city business leaders have begun to move on a plan to rebuild. And for now, momentum is flowing behind a plan to create a new sort of downtown with a mix of offices, apartments, restaurants, and clubs.

Sounds great—but pulling it off will be another matter. Already, many small businesses and residents have decamped, leaving some Wall Street giants. According to the Fiscal Policy Institute, Albany (N.Y.) think tank, the city has lost 22,000 jobs to New Jersey.

Some of those are renting space only at the time being. But the fear in New York is that some big outfits—such as American Express, Deutsche Bank, and Merrill Lynch—that are in temporary quarters across the Hudson

River may never return, thus removing armies of employees from the tax rolls. Already, Dow Jones & Co, ousted from its offices, has decided to keep some units in New Jersey instead of returning them to its headquarters in Manhattan.

With a new mayor elected, the race to head off an exodus begins in earnest.

Wall Street power brokers have given their blessing to the Lower Manhattan Redevelopment Corp., a new state agency to oversee rebuilding. It will

probably have powers to float tax-free bonds, offer cash aid, expedite certain legal reviews, and coordinate efforts among transportation agencies. But will it work? "It's a very good first step," says Henry R. Kravis, founding partner of buyout firm Kohlberg Kravis Roberts & Co. "But the private sector has to be very much a part of it, because it's the private sector you want to keep in town."

HOMELAND DEFENSE

REVIVING LOWER MANHATTAN: THE TO-DO LIST

- Work to retain existing small businesses and residents
- Find a redevelopment agency leader with stature in both the private and public sectors
- Draw on a wide variety of advisers to develop a consensus on a rebuilding plan
- Persuade Wall Street business leaders to stay put
- Set a timetable to ensure that the process doesn't drag on

As the focus turns to rebuilding, the mixed-use idea could fall victim to competing business interests. A high-rent skyscraper yields more revenue than a mix of apartments, stores, and restaurants. Twin Tower leaseholder Larry Silverstein, for one, still wants to erect four 40 to 55 story office towers.

Now, Silverstein could have a powerful new ally. Mayor-elect Bloomberg is on record as favoring more office towers, both to bring back the securities firms and to serve as a magnet for other businesses—such as info tech, biotech, or even the fashion industry.

WRANGLING. Whatever shape this future New York takes, rebuilding the transportation infrastructure will be crucial. One of the downtown area's biggest problems—even before September 11—was inadequate access from other parts of the region. Now, the push is on for new rail lines and additional ferry links.

Any building agenda must weather the storms of New York politics, where almost anything can be blown off course. New York Democrats are unhappy that Governor Pataki and outgoing Mayor Rudolph W. Giuliani, both Republicans, will be the ones to name all nine board members to the state rebuilding agency. And there will undoubtedly be controversy over who will be named to run the agency. "We would be naive to assume that there won't be a political aspect to this," says Deborah Beck, executive vice-president of the Real Estate Board of New York Inc.

It will be at least a year before the World Trade Center site is cleared and building can begin. But before that, a plan needs to be developed that will accomplish the unthinkable in New York: getting business, government, labor, and civic groups to agree. "If business entities see the process moving forward,

they will develop a level of comfort," says Arthur Fried, executive director of the NYC Center for Excellence in Governance at New York University. "If they see it stalling, it will increase the likelihood that they will seek out alternatives." And the last thing needed is for those alternatives to include a move across the river or beyond.

*By Robert McNatt
in New York*

THE POST OFFICE

A HIT TO THE MAIL IS A HIT TO THE ECONOMY

The cost of security, slowdowns, and stalled marketing

Until recently, the mailroom was an afterthought in Corporate America—just a postage meter and a few lowly clerks toiling in a cramped room. No more. With the anthrax crisis raising anxiety and slowing mail throughout the country, executives are suddenly turning their mailrooms into the last line of defense against terrorists.

DuPont, for instance, plans to spend \$200,000 to buy 10 portable X-ray machines and thousands of dollars more for high-tech equipment that tests for explosives and anthrax. "They aren't questioning the costs. They just want the company to be safe," says William Reiter II, U.S. security manager for DuPont.

WIDESPREAD HIT. Just as September 11 forced the airline industry to spend heavily to tighten security, anthrax-laced letters have sent tremors throughout Corporate America, which accounts for over 90% of the \$900 billion spent to generate and mail letters and packages each year. If the attacks persist, says University of Chicago economist Kevin M. Murphy, the money that government and companies will need to spend to help protect mail could be larger than the estimated \$10 billion to \$20 billion that the airlines will have to invest in stepped-up security.

From large international operations such as FedEx Corp. to mom-and-pop commercial printers, mail is big business—accounting for roughly 8% of the U.S. economy. The crisis could affect everything from the U.S. Postal Ser-

vice—which is asking Congress for a bailout—and how companies market to the strength of the economy as a whole. Andrew Hodge, group managing director for economic consultant DRI-WEFA Inc., believes the combination of higher mailing costs and slower service could shave several tenths of a point off productivity and economic growth over the next couple of years.

Most vulnerable are catalogers, credit-card issuers, and other direct marketers. With a normal response rate as low as 1%, they can't afford further consumer reluctance to open their solicitations. Yet that may

be occurring already: In the four weeks after Oct. 6—about the time the first anthrax-laced letter was discovered in Congress—Postal

Service volume declined 10% as consumers retrenched and companies cancelled or scaled back direct-mail campaigns. Among them: Ultimate Software Group Inc., a Weston (Fla.) maker of human-resource software. Fearful that businesses would toss out strange letters, it halved its usual monthly 20,000-letter direct mailing. And of the letters that were sent out, says Linda Miller, vice-president for marketing, "the response rate has been depressed."

HOMELAND DEFENSE

FALLOUT FROM THE FEAR OF ANTHRAX

THE WINNERS

- UPS, FedEx, and other private carriers that track pickups and deliveries
- Private outfits such as Pitney Bowes that run company mailrooms, as well as security companies selling X-ray machines and testing equipment
- E-payment services should benefit from the public's growing desire to pay bills electronically

THE LOSERS

- Catalog retailers, if consumers continue to avoid mail-order shopping
- Credit-card issuers and other direct marketers could get slammed if consumers toss out solicitations
- The U.S. Postal Service, which could see its projected \$1.7 billion deficit soar to as much as \$5 billion in fiscal 2002



BIG OUTLAYS: The Post Office is asking for a bailout

Direct mailers are being forced to change tactics. Catalog retailer J. J. Group Inc. now e-mails customers when a new catalog is on its way. Others, including Fingerhut Co., are redesigning their packages to make sure their logos and return addresses are conspicuously displayed. But it may not be enough: Drivers at United Parcel Service Inc., for instance, are seeing a small but noticeable rise in the number of customers who are refusing to accept packages. On the whole, FedEx, UPS, and other private carriers stand to benefit, though it's too soon to tell by how much.

E-mailers and e-billers could be beneficiaries of the crisis, though. Already, Franklin Resources Inc., the San Mateo (Calif.) mutual-fund giant, says the number of customers signing up to receive quarterly account statements via e-mail instead of snail mail has shot up 50% since early October. And Saks Inc., the parent of Saks Fifth Avenue and other retail chains, says customers paying their October bills by e-mail surged 155% over August levels. That's one way of getting around the fact that for the foreseeable future, business will have to worry that there may be more than the proverbial check in the mail.

By Dean Foust in Atlanta, with Gerry Khermouch in New York, and bureau reports

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EXECUTIVE SUITE

A STUNNING REVERSAL FOR HP'S MARRIAGE PLANS

Now, the Hewletts say they'll vote "no" on the Compaq merger

In January, Walter B. Hewlett, the eldest son of Hewlett-Packard co-founder William R. Hewlett, was asked how he felt Chief Executive Carleton S. "Carly" Fiorina was doing after nearly two years on the job. Hewlett, an HP board member, praised Fiorina for paying attention to the 64-year-old computing giant's roots even as she worked to revitalize the stodgy company. "But only time will tell," he warned. "[Co-founder] Dave Packard was an old basketball player, and he always said 'keep your eye on the ball, because when you start playing to the crowd, things can go wrong.'"

Things couldn't be going more wrong for Fiorina now. Since her Labor Day announcement that HP would buy computer rival Compaq Computer Corp., Fiorina has shuttled across the country trying to win over investors and analysts. But she has made only limited progress, and unhappy investors have sent HP shares tumbling 27% since September. Now, Hewlett may have dealt a death blow to her chances of pulling it off—not to mention her chances of keeping her job. Although Hewlett initially approved the bid, he said in a stunning turnaround on Nov. 6 that he, other family members, and the \$3 billion foundation created by his father would vote their 5% stake against the merger. "With this transaction, we get what we don't want, we jeopardize what we already have, and we compromise our ability to get what we need," he griped.

SLIPPING SHARE. Harsh words, but these are harsh times for both HP and Compaq, and it's not just due to the economy. Hewlett now sees the deal as accentuating the negatives that HP already faces, in part because the combination would expose HP even more to the woes of a stagnating PC market, while diluting the profitability of HP's printing and imaging groups. Uncertainty over the future has weakened both companies and caused customers to look to com-

petitors in droves. On the low end, Dell Computer Corp. keeps hitting them with low PC prices. In just three months, that's eroded the combined HP-Compaq worldwide market share from 19% to 17.7% for the quarter ended Sept. 30, according to researcher IDC. And the gloom looks no better for their high-end server markets, where IBM and Sun Microsystems Inc. are overshadowing the two with the release of hot new products. Both companies

suffered mightily last quarter and analysts expect HP's 2001 earnings to tumble 71%.

Now, even though both companies say they're committed to the wedding—and both boards reiterated their support on Nov. 7—its chances are dimming. Another relative of HP's founders, Dave Woodley Packard, followed Hewlett's criticisms with an announcement that he would not back the merger. The Dave and Lucille Packard Foundation, which owns about 10% of HP stock, says it will continue studying the deal. If the

Packard family votes against it, the combined 17% voting block could be enough to scuttle Fiorina's ambitions, says Jerry Porras, a professor and emiratus at Stanford University's Graduate School of Business. "This thing will snowball," he predicts.

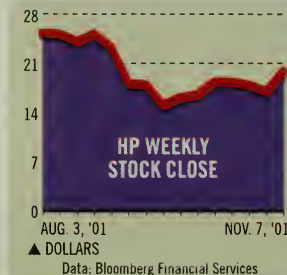
Should that happen, the storm could blow Fiorina from the executive suite as well. Her leadership style, increasingly under criticism. Worse, there were cracks in her support before she decided to buy Compaq. Sources say a headhunter representing at least one HP insider contacted former HP printer chief Antonio Perez this summer to sound him out about taking Fiorina's job.



This followed a string of disappointing profits and her failed bid to buy PricewaterhouseCoopers' consulting wing for \$18 billion. There were also bitter complaints last summer after she laid off thousands in a campaign not used to such tactics. "Her timing appears to be up," says David A. Katz, chief investment officer of Matrix Asset Advisors, which owns 555,800 HP shares and 773,400 shares of Compaq.

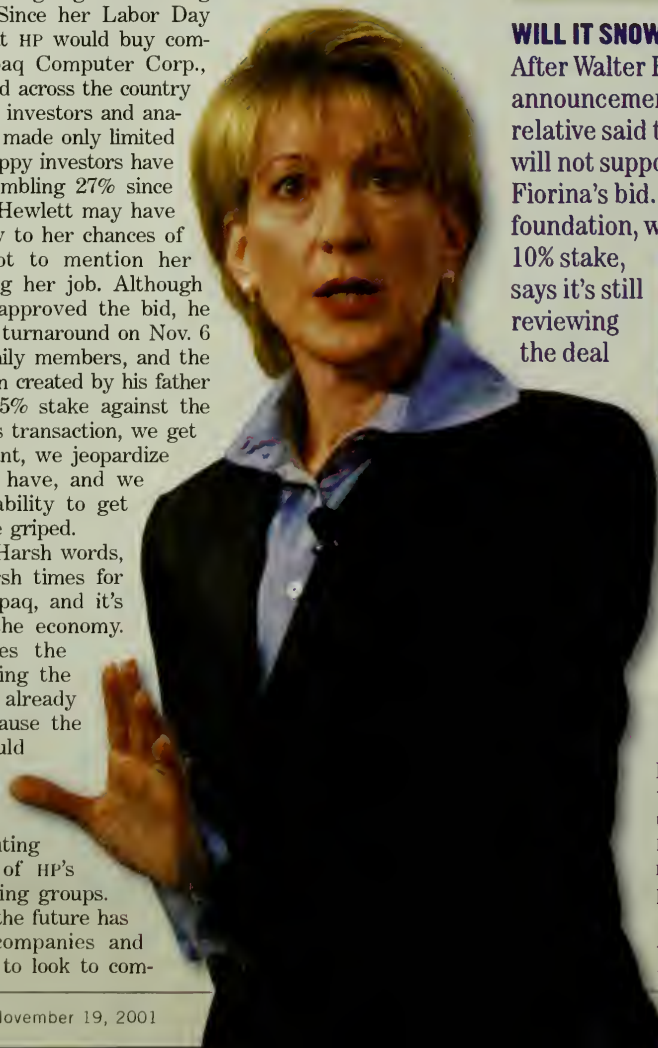
The only ones happy? Rivals like Michael S. Dell. "I don't know what happens if they don't merge, but it certainly creates even more confusion and uncertainty," he says. "Got to love that! HP shareholders won't, though, and that may force Fiorina to dig back into the play book if she wants to survive."

By Andrew Park in Dallas and Pete Burrows in San Mateo, with Robert L. Hof in San Mateo



WILL IT SNOWBALL?

After Walter Hewlett's announcement, a Packard relative said that he, too, will not support CEO Fiorina's bid. The Packard foundation, which holds a 10% stake, says it's still reviewing the deal



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COMMENTARY

By Rich Miller

GREENSPAN & CO. HAVE MORE CUTTING TO DO

Federal Reserve Chairman Alan Greenspan and his fellow central bankers look to be pulling out all the stops in their efforts to get the economy moving again. They've cut short-term interest rates 10 times this year, by a whopping 4½ percentage points. The latest reduction, a half-point cut on Nov. 6, left the overnight interbank federal funds rate at a mere 2%, its lowest level in four decades. The largely symbolic discount rate, the rate the Fed charges on emergency loans to private banks, is even lower, at 1½%.

Appearances, though, can be deceiving. Sure, short-term rates have fallen sharply this year. But real inflation-adjusted rates still remain too high, at least when they are calculated using Greenspan's favorite inflation gauge, the personal consumption expenditure (PCE) deflator. The Fed chairman favors that stat because it seeks to measure price increases on goods and services that people actually use and buy, as opposed to the more widely used consumer price index, which doesn't account for changing consumer preferences. By that measure, real short-term rates stand at 1%.

NOT THERE YET. While that sounds awfully low, it's still not low enough. In past downturns, inflation-adjusted short-term rates have usually had to fall to zero, or even turn negative before the economy has been able to recover. What's more, long-term rates, which have far more of an impact on the economy than the Fed funds rate, have only just recently started to turn down. All that suggests that the Fed needs to keep cutting the nominal funds rates—to 1½% or even lower—to rev up the recession-wracked economy.

For much of this year, Greenspan & Co. have been frustrated by their failure to bring long-term rates down, despite repeated cuts in short-term rates. Long-term rates remained elevated thanks to widespread expectations of a second half economic rebound next year and fears that deteriorating government finances would lead to a stepped-up supply of Treasury securities.

To help get those stubborn long-term rates down, Greenspan got a hand from a former Fed colleague, Treasury Under Secretary Peter R. Fisher. In a move that stunned financial markets and sent long-term rates skidding lower, Fisher announced on Oct. 31 that Treasury was scrapping sales of its 30-year bond. Although Treasury denied it was trying to drive rates down, the action had exactly that effect as traders and investors scrambled to snap up 30-year bonds.

Now Greenspan seems to be looking to Europe for further help in bringing down long-term U.S. interest rates. In what was widely seen as an attempt to nudge the European Central Bank into cutting rates more aggressively, the Fed cited weaker growth overseas as a key reason for its Nov. 6 rate-cut decision.

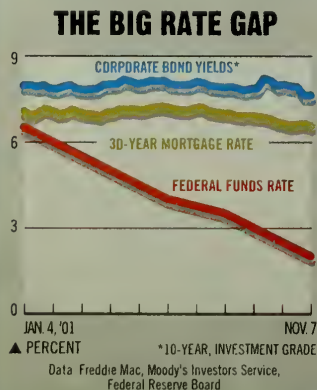
European rates are important because 30% to 40% of U.S. corporate bonds are sold abroad, primarily to European investors. To entice those buy-

ers, U.S. companies need to keep the yields on their bonds competitive. "European rates put a floor under U.S. rates," says Louis B. Crandall, chief economist at consultants R. H. Wrightson & Associates in New York.

Still, the combination isn't enough. Fed policy makers, citing the troubled outlook on Nov. 6, all but admitted they may need to cut rates further. But it's not clear how quickly they're prepared to move. Only one of the Fed's 12 regional banks asked for a half-point cut in the discount rate on Nov. 6, suggesting that at least some policymakers were hesitant about cutting rates so sharply, because they felt the Fed has already done enough to spur the economy.

So how low should the Fed go? After stripping out volatile food and energy costs, the core PCE deflator is running at an annual rate of 1½%. To bring on that much anticipated V-shaped recovery, the Fed needs to bring the funds rate down at least that low. And the sooner it does so, the better.

Miller covers the Federal Reserve from Washington.



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VIDEO GAMES

IN THIS GAME, MICROSOFT IS MORE DAVID THAN GOLIATH

Its new Xbox will have to work hard to beat Sony and Nintendo

Huddled with dozens of other young men around television screens in New York's trendy Metro-nome nightclub and restaurant on Nov. 1, Keith D. Thomas II had neither dinner nor dancing on his mind. The Detroit game-arcade employee punched and kicked his way through a fighting game as he put Microsoft Corp.'s new Xbox game console through its paces during a demo event just two weeks before its official launch. The verdict? "It's intense. Beautiful," Thomas gushed, calling it better than anything on the market. "I was skeptical. I thought Microsoft just did PCs."

Not anymore. With its Nov. 15 launch of Xbox, the PC-industry powerhouse is looking for a piece of the action in the booming video game business. But to achieve its five-year goal of capturing 40% of the \$20 billion console market, Microsoft will need to use every penny of the \$500 million it has earmarked for its initial sales campaign—and then plenty more. This time around, the PC industry's 800-pound gorilla is the underdog in a fight with gaming champs Sony Corp. and Nintendo Co. Microsoft Chief Xbox Officer Robert J. Bach isn't worried about the software giant's lack of experience in the market. "Five years ago, Sony didn't know games either, and they became No. 1," Bach says.

UGLY RECORD. Problem is, Microsoft isn't Sony. The Japanese company has spent decades building an entertainment empire that includes cutting-edge electronics, music, and film. Whenever Microsoft strays into consumer-electronics markets, it often bombs.

That hasn't kept it from trying again. Xbox is a key piece in Microsoft's long-term connected-home strategy, one in which the software giant moves from the



"INTENSE, BEAUTIFUL": Gamers at a New York Xbox demo

home office into the living room. Xbox, along with Microsoft's interactive-TV software and Windows XP networking technology, could provide the foundation for a digital-entertainment empire. In another boost to that strategy, Microsoft on Nov. 7 inked a deal with cable operator Charter Communications Inc. to provide software for 1 million set-top boxes.

Xbox, though, has gotten off to a rocky start. Some demo units installed in stores around the country de-

veloped embarrassing glitches in October, though Xbox execs say these problems have been resolved. Retailers already are fretting that Microsoft has made firm commitments to ship a launch only half of the 600,000 to 800,000 consoles promised months ago. If potential customers can't get the consoles, early word-of-mouth endorsements may never come. "Now the

have to deliver. It's a double-edged sword," says Jeffrey Griffiths, CEO of the gaming retailer Electronic Boutique PLC.

SLAYING DRAGONS. For all its whizzy technology, it's the games that could make or break Xbox. Developers will have completed 15 to 20 Xbox games by the time the holiday season hits, compared with 14 games that will be available for PlayStation 2 and eight for Nintendo's GameCube, which goes on sale Nov. 18. In a counterstrike that week, Sony will release the hotly awaited sequel to its shoot-'em-up Metal Gear Solid 2. "You can't buy love and loyalty in this market. You're only

as good as your last hit," says Sony Computer Entertainment America Inc. President Kazuo Hirai.

Microsoft also will have to slay dragons at a time when the economy is in the dungeon. Unless gamers spot blockbuster exclusive Xbox software titles, the console's \$299 sticker may prove a hard sell over the \$199 GameCube and the \$299 PlayStation 2's wide game selection. That's why Gerard Klaue, Mattison Co. analyst Edward William expects Xbox to capture only about 10% of the market by 2006.

Of course, Microsoft has one big advantage: a \$36 billion mountain of cash and all the time it can buy. Microsoft stands to lose as much as \$10 billion for every console sold. Although hit software—at \$50 a pop—can offset some of that, Microsoft could lose as much as \$1 billion by June, 2004, on hardware, estimates Morgan Stanley Dean Witter & Co. analyst Mary Meeker. With Microsoft's patience and its record for beating the competition, though, execs say let the games begin.

By Steve Hamm in New York and Jay Greene in Seattle



GAME CONSOLES GO HEAD-TO-HEAD

	MICROSOFT XBOX	NINTENDO GAMECUBE	SONY PLAYSTATION 2
U.S. RELEASE DATE	Nov. 15	Nov. 18	Oct. 25, 2000
PRICE	\$299	\$199	\$299
NUMBER OF GAMES AVAILABLE IN U.S.	15-20	7-8	144
TARGET AGE GROUP	16-26	12-17	13-34
MARKETING BUDGET (Millions)	\$500*	\$450**	\$250 ***

*For Xbox, first 18 months, worldwide; **for Nintendo GameCube, 12 months ending March 31, 2002; ***for Sony, 12 months ending March 31, 2002

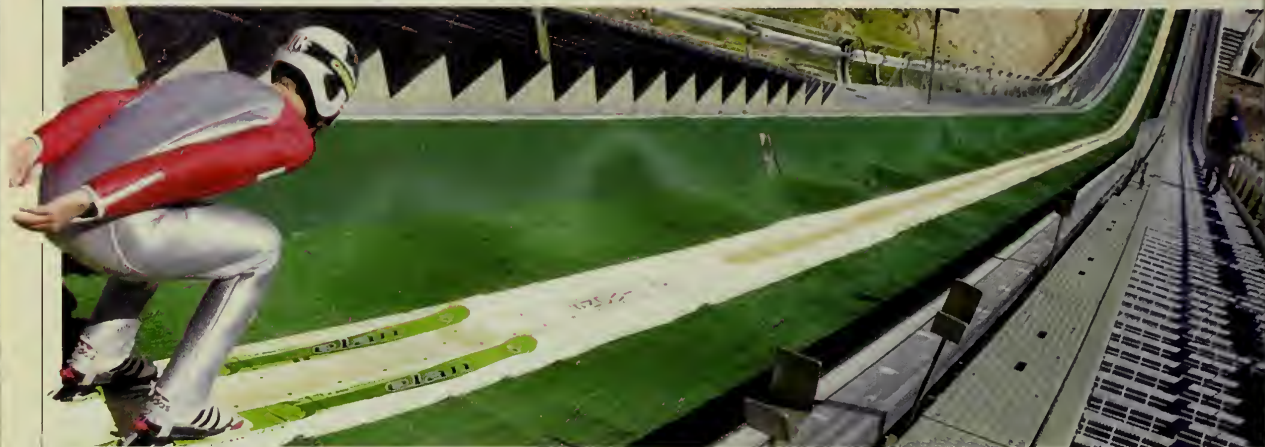


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THE OLYMPICS

DOWNHILL RUN?

Why the Salt Lake Winter Games are looking shaky

For almost three years, a cloud has been hanging over the Winter Olympics scheduled to begin in Salt Lake City in February. First, a bribery scandal erupted that roiled the entire Olympic Movement. Then, sagging economies at home and abroad diminished commercial prospects. And now, in the wake of September 11 and in the throes of the anthrax scare, Salt Lake must contend with unsold tickets, travel fears, corporate pullbacks, and increased security risks. The upshot: The Games are on shakier financial footing than organizers care to admit.

The signs, literally, are everywhere. Cruise along Interstate 80, the highway connecting Salt Lake to the rest of the U.S., and billboards still advertise the availability of tickets. Around 250,000, or 20%, remained unsold at the end of October—less than 100 days before the Feb. 8 opening ceremonies. That compares with a final tally of 89% tickets sold in Nagano, Japan, and 87% in Lillehammer, Norway, the two most recent Winter Games.

But the most nagging question is, will spectators show up? What Games organizers don't say is that if too many tourists

stay home, the event's economic assumptions crumble. Why? Because the entire financial model is predicated upon 1.5 million to 1.7 million visitors spending a certain number of dollars during the 17-day event.

Should sales taxes and other revenues be less than the estimated \$374.2 million that state and local governments will have laid out over the past several years, the Games could actually lose money, says Thayne Robson, a University of Utah professor who has advised SLOC and the state of Utah on the economic feasibility of the Games.

CAPTIVE SPONSORS. So the scramble is on to reassure sponsors and the media that the Games won't end up a commercial flop. "At this stage, we're pretty confident we'll be able to break even," says Mitt Romney, president and chief executive of the SLOC. With a total of \$1.3 billion needed for the Games to avoid red ink, organizers point out that marketing and sponsorship deals with the likes of NBC (page 80), Coca-Cola, and Kodak are locked in place, giving the SLOC an unprecedented \$860 million in corporate funds. Ticket sales have topped \$167 million, and the more than 1.3 million sold represents the highest number of raw ticket sales in Winter Olympics history. And they're nonrefundable. Most major hotels in town are

LEAP OF FAITH: The Games need visitors to show up—and spend

fully booked, having demanded deposits months ago.

To be sure, a financial millstone like the \$1 billion one hung on Montreal taxpayers after the 1976 Games is not like experts say. But some troubling realities lurk below the surface. One is the added cost of security. Congress approved an additional \$24.5 million of a promised \$100 million last month to beef up surveillance and troop presence, add law enforcement personnel, and fence in some areas. But the roughly \$300 million that SLOC thinks it now needs to prevent another Munich is several times the amount it had earmarked in April. If something derails approval of additional funds, SLOC would have to find money for added security—or go without. And organizers still have to sell \$13 million worth of the remaining tickets to hit a target of \$180 million, which Romney says is key to ensuring the Games stay above water.

OFF THE HOOK. The big unknown for hotels and restaurants that had factored corporate extravagance into their plans is how much spending will be reined in. "I don't think [companies] know what to do," says Debra Brandsrud, general manager of the Wyndham Hotel.

Even if there is a shortfall in ticket sales and other revenue, organizers say, there's \$99 million remaining in contingency funds built into the SLOC's budget model. That should keep taxpayers off the hook—assuming, of course, that tourists make the trip and spend money. If they don't, the cloud over Salt Lake will be even darker when the Olympic torch leaves town.

By Douglas Robson in Salt Lake City

THE PLUSES AND MINUSES FOR SALT LAKE

- ⊕ Corporate sponsors have poured in \$860 million
- ⊕ The feds have promised \$40 million for increased security
- ⊕ A \$99 million contingency fund provides a healthy cushion

⊖ The economic slump may mean more frugal entertaining

⊖ Fear of a Munich-like terrorist attack may still keep the crowds away

⊖ The economic model for the Games is predicated on about 1.6 million visitors showing up





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EDITED BY MONICA ROMAN

DAVOS DECAMPS FOR MANHATTAN

FINALLY, SOME GOOD NEWS for New York. The World Economic Forum announced on Nov. 7 that it will hold its annual meeting at the Big Apple's Waldorf Astoria Hotel from Jan. 31 to Feb. 4. For the past 30 years, the prestigious event has been held in the chic ski resort of Davos, Switzerland. The WEF made the move amid growing fears that the Swiss authorities would not be able to guarantee the security of the politicians, business execs, and academics who attend the conference. The change, which will be for one year only, is designed to show solidarity with New York in the wake of the September 11 attacks. WEF President Klaus Schwab says the new location will inspire attendees to find solutions to world problems, including the global economic slowdown and terrorism. "There could

be no better place than New York City to confront these issues," he says.

PHILIP MORRIS EXECS HOP THE POND

WITH SUBPOENAS STILL swirling and earnings under pressure, word is that Philip Morris International will soon close its headquarters just outside New York City, in Rye Brook, N.Y., and shift management of all non-U.S. tobacco businesses to Lausanne, Switzerland. The company has long run its Europe, Middle East, and Africa tobacco operations from several office complexes along the shores of Lake Geneva. Now, senior executives from the company's international headquarters will move across the Atlantic. An estimated 300 other U.S.-based employees of Philip Morris International are expected to lose their jobs in what insiders say is a cost-cutting measure.

A MERGER AHEAD FOR ENRON?

WITH ITS STOCK FALLING to new lows and its credit rating battered, energy giant Enron is desperately searching for new capital. Sources close to the Houston company say it's considering deals with other energy-trading companies, private-equity firms, and blue-chip saviors such as GE Capital. *The Wall Street Journal* and CNBC reported that Dynegy is in merger talks with Enron. The company's financial crisis was sparked by disclosures about some of its off-balance-sheet partnership deals negotiated by former Chief Financial Officer Andrew Fastow. A Securities & Exchange Commission investigation and the threat of liabilities from shareholder lawsuits could make it tough for Enron to land a new investor.

HEADLINER: EVAN GREENBERG

IT'S BETTER IN BERMUDA

WHEN EVAN GREENBERG abruptly resigned 14 months ago as president of American International Group, the \$46 billion-a-year insurer run by his dad Maurice "Hank" Greenberg, some thought the heir apparent would abandon insurance altogether. But now he has landed as vice-chairman and head of reinsurance operations at ACE Ltd., a small insurer based in Bermuda. "Now he has an opportunity to prove himself outside of Hank's shadow," says Brandon Rees, of the AFL-CIO staff retirement plan, an AIG investor that fought for a

more democratic succession process.

While Greenberg, 46, boasts great connections and two decades of working at AIG, it's no easy task to price and sell insurance to insurers these days. And ACE itself is hurting as the September 11 attacks forced it to post a \$390 million loss for the third quarter. Greenberg's family can empathize: Brother Jeff is head of insurance broker Marsh & McLennan, which lost 292 employees at the World Trade Center, while AIG lost about \$500 million as a result of the attacks.

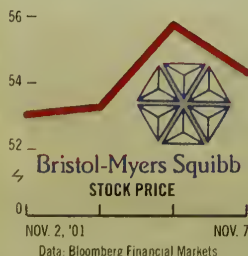
Diane Brady



CLOSING BELL

PEP PILL

Bristol-Myers Squibb got a shot in the arm on Nov. 6 after an appeals court said the Food & Drug Administration should not have approved a cheap, competing version of Bristol's cancer drug Taxol. The news sent Bristol's stock up 4.7% to \$55.76, since the generic version of Taxol could be pulled from the market.



NOW PLAYING AT DISNEY: TWOFERS

MICKY MUST BE GETTING lonely in California. Walt Disney, battling falling attendance at its flagship Disneyland Resort complex in Anaheim, Calif., is slashing prices to lure local visitors to Disneyland and its nearly year-old sibling, Disney's California Adventure park. Earlier this year, Disney reduced prices to help California Adventure's weak attendance. From now until just before Christmas, Southern California residents can buy a two-day pass to both theme parks for \$49, compared to the usual \$48 one-day adult admission price for just one park.

BAXTER TAKES THE BLAME

WHEN A DOZEN KIDNEY-dialysis patients inexplicably died in August in Spain, Bax-

ter International said its blood-cleaning filters were blameless. On Nov. 5, the medical-products company changed its mind and conceded that its filters likely "played a role" in the death of about 50 people worldwide. Baxter said a recently acquired factory in Sweden contaminated the filters by using a chemical to test them for leaks. The company will take a charge of \$100 million to \$150 million to cover liabilities from the deaths at the end of dialyzer production at the Swedish facility.

ET CETERA...

- Bridgestone/Firestone will pay states \$42 million to avoid lawsuits over its tire recall.
- A court cut ExxonMobil \$5 billion bill for punitive damages for the Valdez oil spill.
- Nortel won a \$1.1 billion contract to upgrade Sprint local phone network.



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BY RICHARD S. DUNHAM

AN ELECTION LESSON: TO THE MODERATES GO THE SPOILS

The 2001 off-year elections were a decidedly mixed bag. Wealthy Democrat Mark Warner was elected governor of Virginia while wealthy Republican Michael Bloomberg eked out a victory in the New York mayoral race. Yes, money does matter. Meanwhile, Republican gubernatorial candidates flubbed and fumbled their way to defeat in New Jersey and the Old Dominion. Yes, good campaigns do matter. But amid the confusing messages, one political trend is incontrovertible: Northeastern suburban swing voters are becoming increasingly unhappy with top-of-the-ticket Republicans they consider out of the political mainstream. And that only accentuates the geographic divide between the increasingly Democratic East and West Coasts and the strongly GOP Sun Belt.

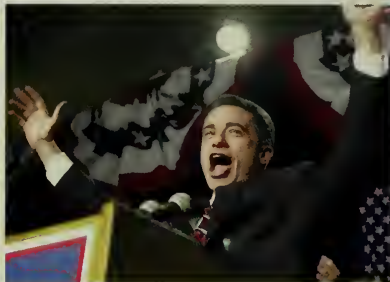
In Fairfax County, Va., a tony Washington suburb captured last year by President Bush, Republican Mark Earley was trounced as his social conservatism and antitax message backfired. And in the Garden State, Republican Bret Schundler's support for private-school vouchers and concealed weapons—along with his opposition to abortion—was anathema to swing voters. "If you want the suburban voters, you cannot take left-wing or right-wing positions," says Diana Evans, a political scientist at Trinity College in Hartford, Conn. "It suggests the wisdom of moderating the message."

That's exactly what successful candidates did on Nov. 6. In New Jersey, Democrat Jim McGreevey distanced himself from his past liberalism to run as a fiscally responsible centrist. Four years ago, when McGreevey was narrowly defeated by moderate Republican Governor Christine Todd Whitman, he lost middle-of-the-road Bergen County by 11

points. This time, he won it by 11. Warner, who made a fortune in wireless technology, was elected in a heavily Republican state by sounding very much like a Republican on issues ranging from economic development to family values. "The model is to develop a unifying economic message and avoid emphasizing divisive, litmus-test social issues," says Robert D. Holsworth, a political scientist at Virginia Commonwealth University.

That was the formula George W. Bush successfully adopted in 2000. But it was one that eluded the GOP a year later, as the party nominated true believers for governor: Schundler, a protégé

conservative publisher Steve Forbes and former Housing Secretary Jack F. Kemp. Kemp ran as a committed supply-sider and never caught fire. Even National Republican Congressional Committee Chair Thomas M. Davis III (R-Va.) concedes that Schundler "campaigning on a platform



WARNER AND MCGREEVEY: Both candidates steered a middle course to victory

that was out of touch with New Jersey voters."

Like Schundler, Earley stuck to a hard-line antitax message. But Earley, who was backed by religious broadcaster Pat Robertson, ran into resistance from business leaders, tech-heavy Northern Virginia who favor a sales-tax increase for road construction. Swing voters abandoned Earley, even as they voted for GOP candidates down the ballot.

Not surprisingly, Republicans' spin on their 2001 defeats—that they were individual flukes, while Democratic National Committee Chair Terry McAuliffe sees "a huge shift" in political momentum. Neither view is accurate. For Republicans, though, the election of 2001 again demonstrates that the GOP can't win in the suburbs, it will become increasingly difficult for the party to compete on the coasts.

CAPITAL WRAPUP

TOP NUMBERS

► While President Bush's popularity might not translate into Republican gubernatorial victories, it has earned him a place in the history books. With job-approval ratings above 80% for six consecutive weeks, Bush has become the first President to be so popular for so long since Lyndon B. Johnson in the aftermath of the Kennedy assassination. The bad news for Bush: History tells us these ratings can't last forever.

ARMY RETREATS

► A month ago, House Majority Leader Dick Armey (R-Tex.) declared that airport security personnel should not be federal employees because that would just mean 27,000 new union members. On Nov. 6, Armey reversed himself, saying it was "insignificant" whether they work for the feds or private contractors. Did pressure from corporate execs concerned about empty planes help change his mind?

AL WHO?

► It has been a year since the Presidential election that wouldn't end. And according to a Nov. 2-4 Gallup Poll, half the country still thinks Bush won fairly, while the rest say he won on a technicality—or stole the election. But voters now seem happy that Al Gore wasn't victorious. By 61% to 35%, Americans say they would vote for Bush today. Three months ago, Gore trailed by a single point.



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TWILIGHT OF A REFORMER?

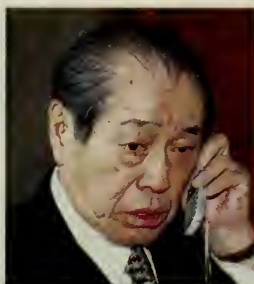
Koizumi's chances for meaningful change are fading fast

He still garners huge ratings in the polls. Adulatory citizens press around him wherever he appears. And Japanese Prime Minister Junichiro Koizumi can still score victories. On Oct. 28, his ruling Liberal Democratic Party picked up two seats in key parliamentary by-elections, giving the party a majority in the powerful lower house for the first time in 16 months.

A day later, the legislature approved Koizumi's controversial request to back up American forces fighting Afghanistan with noncombat Japanese troops.

Yet six months into his tenure, Koizumi has made almost no progress toward doing what he was elected to do: shake up the bureaucracy and turn the economy around. Bankers are balking at his efforts to force bad-loan write-offs. Ministries are sabotaging his plans to abolish public corporations. Headline-grabbing proposals—such as a pledge to hold the fiscal deficit in check by keeping government bond issuance under \$250 billion next year—may be dead on arrival when they come up for debate in the next parliamentary session. Meanwhile, the economy is sliding rapidly into recession, deflation is worsening, and joblessness is at record levels. The bottom line: Koizumi's room to maneuver is shrinking fast. So are chances for effective reform. "Japan has no time to waste," says Takashi Imai, chairman of the Japanese business group Keidanren and head of Nippon Steel.

The obstacles for Koizumi are daunting. By yearend, the Finance Ministry has to present its 2002 budget for review. Koizumi's proposals for the budget will set his opponents howling, since they call for a big dial-back in



NONAKA: LDP bigwigs are attacking Koizumi

government spending and dismantling state-backed corporations. But it's unclear if his ideas will get into the final plan. "The anti-revolutionary movement has been very intense," says Takashi Inoguchi, a professor of political science at Tokyo University.

The stiffest opposition Koizumi faces comes from rivals within his own LDP. In the wake of the popular politician's rise to power last April, LDP hard-liners lay low as the party prepared for crucial July elections to the parliament's upper house. Koizumi's 90% approval rating secured an LDP victory

in that summer contest. But now that their parliamentary seats are safe, "the party is reverting back to the LDP of old," says Commerz Securities political analyst Hitoshi Ichio. Key politicians and bureaucrats will do all they can to keep Koizumi from dismantling their pork-barrel apparatus.

Consider the friendly fire coming from the LDP's largest faction. Party bigwig Hiromu Nonaka has come out against Koizumi's proposal to dispatch an Aegis-equipped battleship into position off the coast of Pakistan. But some analysts believe Nonaka is just grabbing any chance he can to undermine Koizumi. Nonaka and his protégé, Makoto Koga,

strongly support the 77 state-funded companies and 86 other quasi-public corporations that Koizumi wants to curb because they drain huge sums from the budget.

BODY BLOW. One of the most expensive is Japan Highway Public Corp. (JHPC), whose road-building and maintenance operations will cost the Japanese taxpayer \$2.5 billion this year—an expenditure all the more galling because many of its projects are allegedly devised to channel funds to party-connected contractors. Koizumi has vowed to freeze new expressway construc-

KOIZUMI STUMBLES POLITICALLY...

- Pledge to abolish all state-run corporations bogged down by LDP, bureaucrats
- \$250 billion cap on next year's budget threatened by falling tax revenue
- 3-year cleanup deadline on bad loans seen unrealistic

...AS JAPAN'S ECONOMIC FUNK DEEPENS

- Unemployment at new record high of 5.3%
- Industrial-production index at seven-year low
- Household spending down for six straight months

Data: BusinessWeek



tion as a prelude to closing JHPC down. "The freeze is nonsense," says Koga, a former head of the LDP's research commission on highways. "We can't accept it." He says the government must fulfill its promise to local governments to build new highways.

Koga and others are arguing that Koizumi's austerity plan will deal a body blow to a sick economy. The news certainly isn't going Koizumi's way. The government is expected to concede within the next few days that its earlier estimates for growth this year in gross domestic product are way off. GDP contracted 0.8% in the quarter ending in June. And then came the blow from the September 11 attacks. As a result,

The Premier may have to make ugly deals with the old guard

government tax revenue is likely to fall far short of projected levels.

That means Koizumi will be harder pressed than ever to contain government borrowing—a key part of his platform. LDP conservatives have already wrung a new stimulus package out of the Prime Minister. Meantime, the bureaucracy has plans to short-circuit any cuts in spending. In response to a Koizumi plan to deep-six the state-owned Japan National Oil Corp., which has accumulated \$3.5 billion in losses in recent years, the Economy, Trade & Industry Ministry may simply shuffle operations and ensure its survival under a new name.

One important policy aim is likely to

come to fruition in the current legislative session. The Diet is set to approve Koizumi's proposal to beef up funding for the Resolution & Collection Corp. The RCC is supposed to engineer the restructuring and rescue of Japan's banks, the 15 largest of which are saddled with at least \$145 billion in bad loans. What the bill doesn't do, critics stress, is commit the government to earmarking more money to bail out the banks, an idea that is political dynamite. As a result, Koizumi's vow to restore the bank system to health within three years is looking hollow.

PORK-BARREL CAP. Can Koizumi still pull off reform? His supporters haven't given up. The strategy, says one source familiar with the Prime Minister's tactics, was for Koizumi to aim high rhetorically during his first months in office to signal his seriousness about reform, wait for the protests from

conservatives to reach a crescendo, then make tactical compromises that achieve most of his goals. Thus, doing away with public corporations may prove impossible in the short term. But putting a cap on pork-barrel spending would be a real accomplishment.

Maybe so—politics everywhere is the art of compromise. But many observers instead view Koizumi's

enemies as simply too powerful for him ever to win against them. "On the economy, Koizumi seems to be incapable of doing anything," says Inoguchi of the University of Tokyo.

At least the old guard can't force Koizumi to resign. Such a naked grab for power would infuriate voters. But if the hard-liners can force Koizumi to make ugly compromises on one proposal after another, his popularity could eventually sink and leave him at the mercy of the party bosses.

A pretty grim scenario. Koizumi could yet take drastic action—such as reshuffling his Cabinet and stacking it with Young Turks, or even calling lower house elections to chase the recalcitrant LDP factions out of power. There's no sign of that, though. Instead, the evidence that Koizumi's administration will be one more opportunity lost continues to mount.

*By Chester Dawson
in Tokyo*



TAIWAN PORT: Trade with China may expand

TRADE

CAN TWO CHINAS LIVE TOGETHER IN THE WTO?

Taiwan's entry may further snarl relations with Beijing

Fast-forward to late 2002. Both China and Taiwan have been in the World Trade Organization for nearly a year. Without warning, China slaps restrictions on polyester imports from Taiwan, which are steamrolling mainland rivals. Taiwan takes the squabble to the WTO's Dispute Settlement Board in Geneva. But China refuses even to attend the proceedings, claiming that what happens between Beijing and Taipei is an internal Chinese affair. The two sides engage in a cycle of escalating sanctions, and trade across the Taiwan Strait shrivels. In this worst-case scenario, the WTO's reputation is besmirched—as is China's claim to play by international rules.

Amid the hoopla surrounding Beijing's entry to the WTO, little has been said about what Taiwan's membership will mean for cross-strait ties. For Taipei, its expected January entry is a diplomatic coup. Taipei sees WTO membership as a tangible acknowledgment by the rest of the world that Taiwan is indeed a separate entity from Beijing.

At the same time,

Taipei hopes joining the WTO will bring more trading privileges and legal protections, allowing it to boost trade and investment with China—without having to kowtow to Beijing. “We’re expecting more orderly and friendly ties under WTO,” Taiwan Premier Chang Chun-hsiung told *BusinessWeek*. “After we join WTO, we’ll gradually open trade, investment, and cross-strait remittances. We’ll even allow direct investment from the mainland into Taiwan.”

MORE CARDS. Chang may be too optimistic. His assumption is that the Chinese leadership will be more reasonable once both sides join the WTO and are forced to play by its rules, which are designed to lower tariff barriers and

encourage trade and investment between nations. But Beijing wants Taiwan to agree there is only one China—in other words, cede sovereignty before talks to liberalize trade and transportation take place.

Moreover, Beijing holds more cards than Taipei. Mired in its worst recession ever, Taiwan has nowhere to go but China, both as a source of cheap la-

bor and a market for Taiwanese exports. Furthermore, under the WTO, Taiwan must open its economy to China. That will bring not only opportunities but security risks as the mainland becomes more deeply involved in Taiwan's economy. Premier Chang vowed not to invoke national security opt-outs to discriminate against Chinese products. Still, he frets that Beijing might try to manipulate the stock market or slip in spite among a growing flood

mainland visitors. So Taipei won't completely open its financial markets—meaning mainlanders won't be able to scoop up stocks and property. “We worry the mainland will take advantage of WTO entry to sabotage [our] economy,” says Chang.

Of most concern, however, is the possibility that Beijing will simply ignore Taipei's WTO membership. On Oct. 2, Zhang Mingqing, a spokesman for China's Taiwan Affairs Office, reminded Taipei that Beijing sees trade, economic exchanges, and direct links as domestic issues. “We don't need WTO rules to handle internal matters,” he said. The two sides also are miles apart on how to resolve future disputes. According to a trade official in Beijing, China wants to skip the WTO and settle trade spats informally with Taiwan, as it does now with Hong Kong. Not only would that hurt WTO credibility but it could be bad for China. “It would undermine so much of what they have tried to accomplish,” says Nicholas R. Lardy, a senior fellow at the Brookings Institution.

Given all the complications and potential humiliation, WTO membership looks to be a bittersweet triumph for Taiwan. Whatever satisfaction it gets from joining an international body will be tainted by continuing pressure from Beijing. Economics is driving the two sides closer. But for now, at least, politics will put a limit on just how far the relationship can go—WTO or not.

By Mark L. Clifford in Taipei, with Alysha Webb in Guangzhou, and Dexter Roberts in Beijing

WHAT MEMBERSHIP WILL MEAN FOR TAIWAN

- Average tariffs cut from 8.2% to 5.53%
- Farm subsidies cut \$110 million, or 20%, by 2002
- 100,000 farmers to lose their jobs over five years
- GDP growth to be spurred 0.63% each year for the next five years

Data: Office of the Prime Minister (Taiwan)

BusinessWeek online

For an extended interview with Premier Chang Chun-hsiung, please see the Nov. 19 issue online at www.businessweek.com



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ARGENTINA

THINKING THE UNTHINKABLE

Argentina could be forced to cut the peso's peg to the dollar

For more than a decade, no matter how dire the straits Argentina's economy was in, one option was unthinkable—devaluation. Miserable memories of hyperinflation made the rigid regime that locked the peso's value at \$1 sacrosanct. Argentines cherished the buying power of a peso with greenback characteristics.

All that changed on Nov. 1, when a solemn President Fernando de la Rúa asked Argentina's foreign and domestic creditors to accept lower interest rates and longer maturities on some \$95 billion in bonds. With that—effectively the largest sovereign default in history—Argentina surrendered to market forces. For nearly four years, successive governments tried to impose enough fiscal austerity so Argentina could pay its national debt. But that put the economy into perennial recession.

HOT TOPIC. Now, the government has admitted it can't sustain its old policies, of which the dollar peg is the last vestige. De la Rúa and Economy Minister Domingo Cavallo keep repeating the no-devaluation mantra. But the peso's future is the hot topic for everyone from editorialists to cab drivers. "Overnight, we've gone from three years of agonizing recession to rapid implosion," says Benny Thomas, Latin American equity fund manager for T. Rowe Price International Inc. "Who's not looking at the currency issue?"

Many investors still doubt the proposed debt swap, supposed to save \$4

billion in interest costs, will free up enough cash to stimulate Argentina's \$280-billion economy. So economists say that to get the economy moving, Argentina must free itself from the stranglehold of an overvalued currency, which made exports uncompetitive and sent manufacturers fleeing to Brazil.

Devaluation would boost exports, but it would also have a brutal impact on households and banks, since 65% of private-sector debt is in dollars, including mortgages and car loans. Argentines would suddenly have to pay off these loans in devalued pesos, and many would default.

The situation just gets more precarious. Fearing a default will weaken banks, consumers have been spiriting money out of the country. Deposits have fallen 14.4%, to \$73.6 billion, since late June. The more cash flees, the shakier the peg. "Abandoning the peg is inevitable unless something miraculous happens and capital flight is reversed," says Amer Bisat, emerging-market debt portfolio manager at Morgan Stanley Dean Witter & Co.

Privately, analysts say the dollar peg's end could be weeks away. In that case, there are three choices: outright devaluation; adopting the dollar at the current

Cavallo in creating the currency board.

But dollarization would also lock the uncompetitive cost structure that Argentina can't sustain. For the policy to work, say Hanke and other proponent politicians would need to get serious about the budget. Dollarization at less than 1-to-1 would make Argentina more competitive, but wouldn't fix its fiscal profligacy either.

Analysts say the real danger would be from a sloppy devaluation. That may be where Argentina is heading. The government has authorized Argentina cash-strapped provinces to pay workers in one-year notes that circulate like currencies on par with the peso. The scrip increases the money supply—aren't backed by dollars. "It's easy to see how this could get out of hand fast and

lead to the emergence of a parallel currency," says Christian Strack, a Latin America strategist at Commerzbank in New York. Inflation could resurge, and foreign investors would shun Argentine assets.

One way to limit the devaluation fallout would be to combine it with dollarization, simultaneously revaluing dollar-based obligations at the new exchange

rate. In other words, if the peso were devalued by 20%—which analysts say is the minimum needed—a \$100 debt would be reduced to \$80. Says economist Barry Eichengreen, an emerging markets expert at the University of California at Berkeley: "It would be a radical step, but the time for radical steps has come." Argentina is in a deep hole.

By Joshua Goodman in Buenos Aires with bureau reports

TAKE THE MONEY AND RUN



Data: Central Bank of the Republic of Argentina



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COMMENTARY

By Jack Ewing

WHY GERMANY'S ECONOMY IS STALLING OUT



German Chancellor Gerhard Schröder wants to close a chapter of his nation's history, when Germany played a limited role in foreign affairs. So in early November, Schröder publicly committed to sending 3,900 troops to help Washington's fight against terrorism. If these soldiers of the Bundeswehr do end up in service on the Afghan border, it would mark the first time German forces joined an offensive action since the final days of World War II.

The thought of German soldiers in action can still trigger a shiver. The stamp of Nazi boots, after all, echoes yet in the ears of the world. But Schröder is right to take this step. A former peace activist and the son of a Wehrmacht soldier who died in combat, he is trying to create a new epoch for Germany, where the nation's geopolitical strength matches its economic force. "It is a new phase," says Karsten D. Voigt, coordinator for German-American cooperation in the German Foreign Office. And it's time for that phase to begin. Virtually all German political and business leaders were either children during World War II or not even born: These are not war-mongers. And as the biggest country in Europe, Germany should lead the way to a new era of statecraft.



ROADBLOCKS Unless Schröder revives reform, the slump will just get worse

And yet Schröder will commit a major blunder if he focuses on his diplomatic forays at the expense of the home front. In the same week Germany announced plans to field troops, some frightening economic statistics made the headlines. Factory orders in September had their steepest slide in six years, and the economy lost some 27,000 jobs in October—the biggest loss in almost three years. Clearly, the downward turn in the business cycle is hitting Germany hard. But this is more than just a cyclical bout of bad news. The sad fact is that Schröder's own drive to

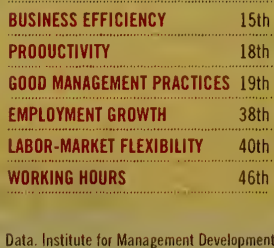
reform the German economy has stalled. He has to revive reform fast—for the sake of Germany's 3.9 million unemployed and for the sake of Europe, which takes its cues from German policy. "Germany's essential," says Noël Goutard, chairman of the supervisory board of French auto-parts maker Valeo. "Europe can't prosper without Germany."

Finally, the success of Germany's new foreign policy depends on getting the economic formula right. Europe's ability to assert itself in the world depends on the outcome of its bold economic experiments, especially monetary union and its decision to expand the European Union to the east. Neither of those experiments will

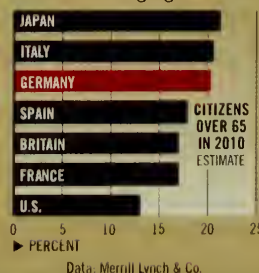
Germany's Economy Is One of the World's Biggest...

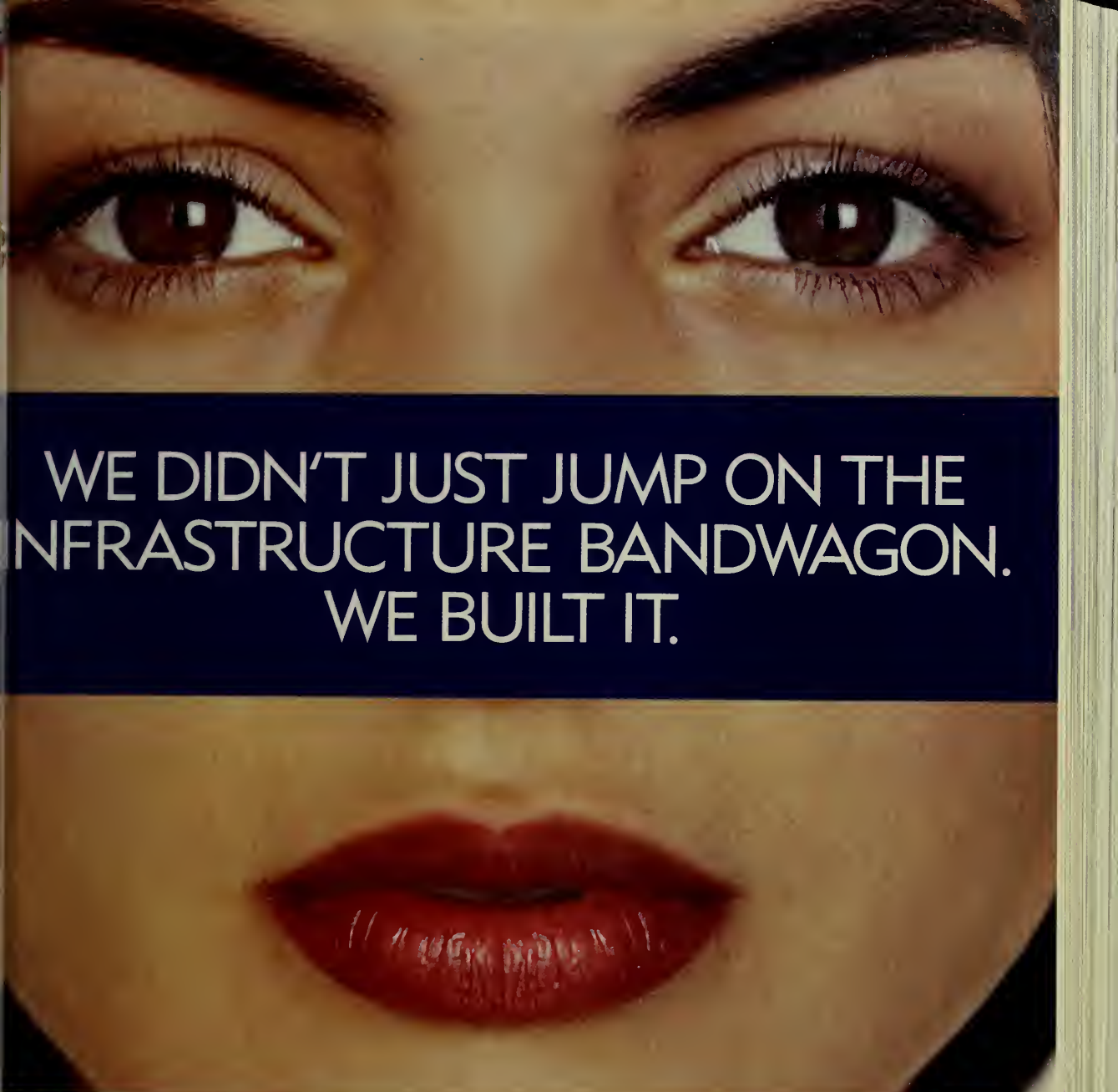


...But It's Falling Behind in Key Areas...



...And Its Population Is Aging



A close-up photograph of a woman's face, focusing on her eyes and lips. The top half shows her eyes looking directly at the camera. The bottom half shows her lips, which are slightly parted and coated with a glossy red lipstick. A dark blue horizontal band is superimposed over the middle of the image, containing white text.

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work if Germany steadily weakens.

Unfortunately, that's just what is happening. German economic growth, which hit 3% last year, is once again reverting to the subpar rates of the 1990s. If Europe goes into recession, as now looks likely, only Germany can lead it out. But Berlin's ability to lead is sadly diminished. "Germany used to be one of the growth motors of Europe," says Peter Müller, prime minister of the western state of Saarland and a member of the opposition Christian Democrats. "Now we're a brake."

Just a year ago, Schröder's pace of reform seemed right on target. He cut taxes, took the first steps towards mending the broken pension system, and encouraged the immigration of workers with needed skills. Critics said these steps were needed, though not bold enough. Schröder, however, seemed to promise more. And there was indeed a growth spurt.

But it didn't last. This year, growth will slip to 0.7%. Unemployment, at 9.5%, remains far ahead of the U.S. rate of 5.4%. The downward lurch shatters any idea that Germany can quickly recover the economic dynamism of the 1960s and 1970s.

Schröder should consider the grim news a call to action. Sure, he faces reelection next year and doesn't want to anger voters with unpopular spending cuts or tougher pension reforms.

But he has left so much undone: loosening up the labor market, redesigning social welfare to get the long-term jobless off the dole, cutting red tape, slashing taxes further.

Those are longstanding tasks: The Chancellor should try thinking out of the box as well. As the economy slows dangerously, Schröder could reduce capital-gains levies for smaller companies to encourage them to restructure. He should push harder on some innovative ways to tweak the welfare system. One idea is to offer some unemployment payments for those who actually get minimum-wage jobs. It's a smart way to lure people back into the workforce, and it's time to do it. He could also exempt smaller companies from some of the more onerous provisions of German labor law.

GUNG-HO. And just as Schröder is using his statecraft on the world stage, he has to use considerable diplomacy to prod both his party stalwarts and the corporate Establishment to accept change. The left wing of his party is holding Schröder back: He has to spell out the political advantages of faster action.

And the Chancellor needs cooperation from Germany Inc., which has a lot to answer for. Industry associations are gung-ho for tax cuts and less regulation. But threaten their interests, and they clamor for protections as much as any line worker. Earlier this year, for exam-

THE REICHSTAG
With elections looming, politicians are reluctant to cut spending or loosen labor regulations

ple, German business torpedoed reforms that would have created Europe-wide takeover rules and made hostile bids easier to pull off. Schröder has also made it possible for banks and insurers to sell, tax-free, their

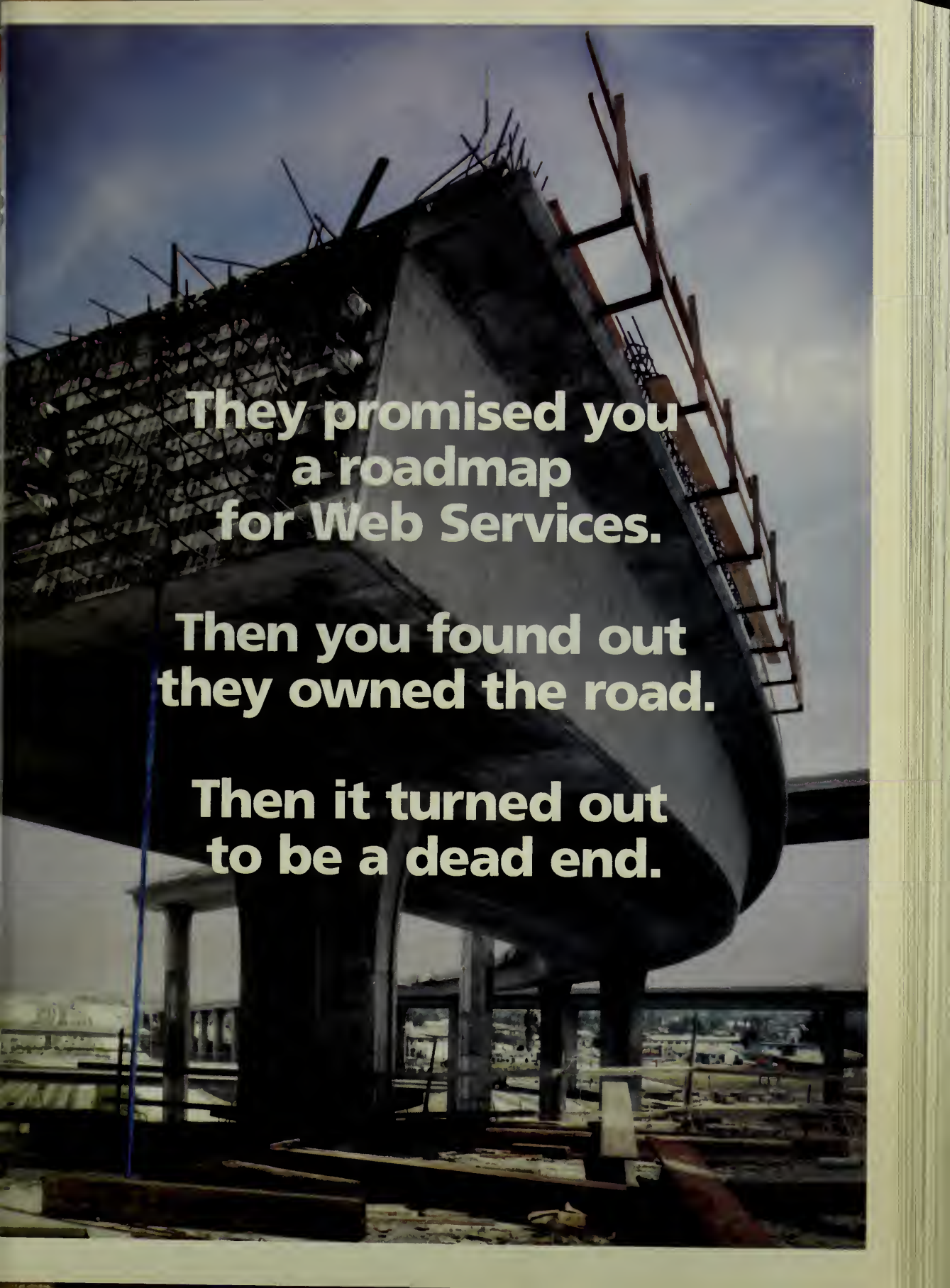
huge stakes in industrial companies. That tax break, effective on Jan. 1, was supposed to trigger the restructuring of Corporate Germany. Instead, few sell-offs have been announced.

The irony is that ordinary Germans may be more willing to change than their leaders give them credit for. For example, 56% of Germans believe unemployment benefits are too generous, according to a poll by the Allensbacher Institute. "People voted for Schröder in the expectation that he would modernize the country," says pollster Manfred Güllner, CEO of the Forsa Institute in Berlin. Timid leaders, not reluctant citizens, are the biggest obstacle, he says.

Schröder should put aside his fears, harness this public opinion, and push hard to get things done. It may be easier than he thinks. When Germans do decide to change, they can move in a hurry. "You're seeing a near-critical mass among the elite," says John C. Kornblum, former U.S. Ambassador to Germany and now the chairman of Lazard Frères in Germany. "I think we're on the verge of major change." For Germany's sake—and Europe's—he had better be right.

Frankfurt bureau chief Ewing covers German politics and business.

"Germany used to be one of the growth motors of Europe. Now we're a brake"



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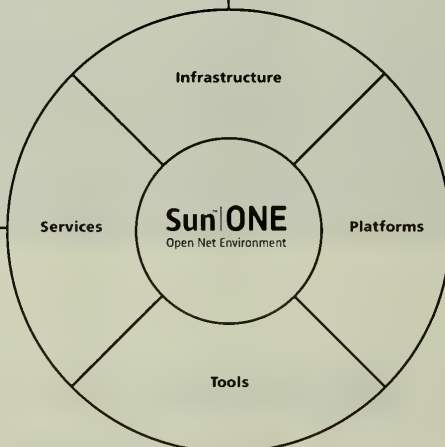
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CAN THIS NEW SURGERY ACTUALLY REVIVE A DYING HEART?

Upstart Bioheart's complex cell-transfer procedure offers hope against America's No. 1 killer

Ten people in Europe are making medical history. Their damaged hearts have all been rejuvenated with the help of implanted cells taken from their thighs. The technique was pioneered by a tiny Fort Lauderdale startup called Bioheart Inc., and it is groundbreaking for a number of reasons—not least because it offers hope to millions of heart attack victims. But the technique also marks an important step forward in the nascent field of medicine known as tissue engineering. Scientists have successfully prodded the human body into regrowing skin, cartilage, bone, and even corneas by manipulating cells. The Bioheart patients, however, represent one of the first successes in regenerating portions of a more complex organ.

It is still very early days for this technique, known as myogenesis, but it is already generating considerable buzz among heart disease specialists. Status reports from the 10 patients will be given at a special session during the American Heart Association's annual meeting in mid-November. Guidant Corp., a maker of medical devices, was intrigued enough to invest \$1.5 million in two-year-old Bioheart in June. And another tissue engineering company, Osiris Therapeutics Inc., is developing a similar technique, which has yet to be tested in humans. "We don't have many good options" for treating heart attacks, says Dr. Donald D. Glower, professor of surgery at Duke University Medical Center. "This is one of the more promising avenues. It could eventually become very, very powerful tool."

In fact, tissue regeneration may be

the most promising development in the treatment of heart disease since the advent of transplants. The need is certainly desperate. Heart disease is the biggest killer in the industrialized world, responsible for one out of every 2.5 deaths. Over 17 million people in the U.S. have coronary disease, and 7 million suffer heart attacks each year.

Heart disease is so deadly because, unlike most organs in the body, the heart does not grow new cells to replace worn ones. When heart cells die

during an attack, usually because they are deprived of oxygen, that portion of the heart becomes dead tissue. The rest of the organ must work that much harder to compensate, until it fails as well.

The best cure is a heart transplant. But the shortage of available organs, not to mention the dangers inherent in the process, makes this an impossible solution for most patients. So for the past 30 years scientists have been searching for a way to regenerate heart tissue.

Enter Howard J. Leonhardt, founder and CEO of Bioheart. Leonhardt sold off the first company he started, a maker of cardiac stents, in 1998. That summer he was watching TV and happened to catch the movie *Superman*, in which Clark Kent's father dies of a heart attack. He was inspired to come up with a solution to this disease and started Bioheart that August. Leonhardt soon assembled a team of scientists to study cell types that might be used to regenerate heart tissue.

VITAL CHOICE. Most of the research in myogenesis, done in academic labs, has focused on embryonic or adult stem cells, the precursors to all the body's tissues. But the Bioheart team found no way of ensuring that the stem cells turned into heart, as opposed to bone or cartilage.

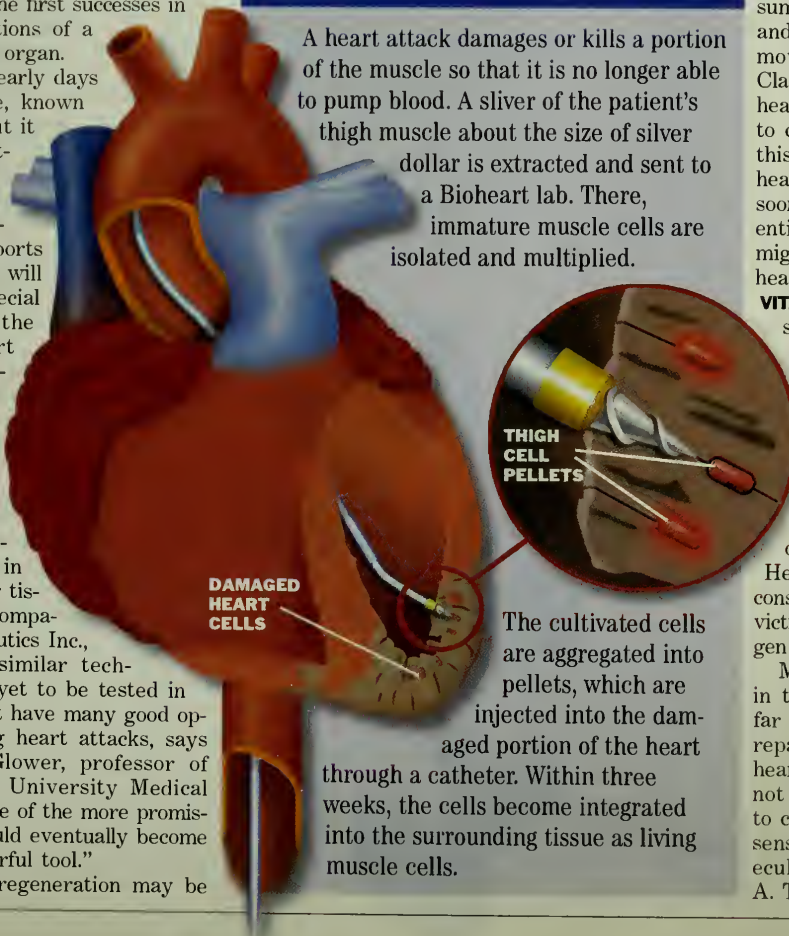
Heart muscle cells were also considered, but these could fall victim to the same lack of oxygen that killed the original cells.

Muscle cells such as those in the thigh, in contrast, are far more robust and able to repair themselves. Since the heart is also a muscle, it did not seem that much of a leap to combine the two. "It made sense to me as a muscle molecular biologist," says Doris A. Taylor, an associate profes-

FROM THIGH TO HEART

Bioheart's method for regenerating the heart

A heart attack damages or kills a portion of the muscle so that it is no longer able to pump blood. A sliver of the patient's thigh muscle about the size of silver dollar is extracted and sent to a Bioheart lab. There, immature muscle cells are isolated and multiplied.



The cultivated cells are aggregated into pellets, which are

injected into the damaged portion of the heart

through a catheter. Within three weeks, the cells become integrated into the surrounding tissue as living muscle cells.

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sor at Duke University Medical Center and chairman of Bioheart's scientific advisory board. "One of the really nice things about this technique is that it's very straightforward."

Straightforward, but not simple. The patient first has a silver-dollar size portion of thigh muscle removed. The tissue is sent to a Bioheart lab, where it is put through an 18-step process to select out and multiply immature muscle cells called myoblasts. The process takes 21 days, and every step must be strictly controlled, says Leonhardt: "Even one minute off can ruin the cells."

Once the myoblasts are ready, they are shipped back to the hospital. Using a specialized catheter, 10 to 30 pellets, each consisting of some 50 million cells, are injected in and around the damaged area of the heart. New cells integrate into the area within three weeks, with about eight weeks needed for functional improvement, says Leonhardt. Because the original cells are taken from the patient, there is no danger of rejection.

POSITIVE SIGNS. So far, the catheter procedure has been tried on a 78-year-old woman in Rotterdam, in June. Two other patients in Europe are waiting for their myoblasts to be processed and will likely be operated on in December. However, Dr. Phillippe Menasché of Hôpital Bichat in Paris has implanted Bioheart-cultured cells in nine patients since June, 2000, during open-heart surgery.

One of Menasché's patients died after the operation, but the other eight, as well as the woman who received her cells via catheter, have all shown measurable improvement. Intriguingly, the new cells didn't turn into heart tissue, which would leave them vulnerable to the same disease that destroyed the initial cells. Instead, they retain most of the characteristics of hardy myoblasts.

There are still many questions, however. Menasché notes that with his patients, it could be the bypass surgery that produces the improvement. Controlled clinical trials must be conducted to determine the therapeutic benefit of the myoblasts. Bioheart plans to file an application with the Food & Drug Administration this month for permission to start clinical trials in the U.S.

There are also concerns about whether the implanted cells will remain stable over time. "We really don't know, and have no good way of knowing, what the cells are doing *in vivo*," says Taylor. Still, she says, "we don't necessarily have to know, as long as it works." Heart disease patients would surely agree.

By Catherine Arnest in New York

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Developments to Watch

EDITED BY OTIS PORT

SNARING LIGHT IN A CRYSTAL TRAP

LAST JANUARY, TWO RESEARCH teams startled the scientific world by briefly stopping photons of light—those speedy critters that normally zip through space at 186,000 miles a second. Even though the photons were halted for no more than a millionth of a second, that's long enough to store interim number-

crunching results in a superfast optical computer. Trouble is, both teams corralled their photons in a gas—one using a hot rubidium gas and the other employing an ultracold sodium gas. A solid trap would be easier to work with, pundits noted at the time.

Now, light has been stopped in an exotic crystal by a group led by physicists Philip R. Hemmer at the Air Force Research Laboratory and M. Selim Shahriar at Massachusetts Institute of

Technology. First, they took an yttrium-silica crystal laced with the element praseodymium and chilled it to a frigid -268C. That helped slow light to a molasses-like 45 meters per second and allowed it to be stored for half a millisecond before being regurgitated. Not a world record, but it's adequate for optical computing. The team, which submitted a report to *Physical Review Letters*, hopes to extend the storage time to as long as tenths of a second.

INNOVATIONS

■ A better sunscreen from bugs that never see the sun? That's what Sederma, a French cosmetics company, is developing. Using microbes gathered from so-called hydrothermal vents almost a mile down in the Pacific Ocean, Sederma is brewing a secret potion for a "smart" tanning lotion and other skincare products, according to the Nov. 2 issue of *New Scientist* magazine. As the sun rises higher in the sky, the potion will respond to hotter temperatures by increasing its protection against harmful ultraviolet rays.

■ The American Physical Society's annual plasma physics meeting, which ended on Nov. 2, had encouraging news for fusion-energy proponents. Using a powerful new IBM supercomputer at Lawrence Berkeley National Laboratory, a research team from Princeton University's Plasma Physics Lab ran the most detailed simulation yet of a commercial tokamak reactor. Fusioners have worried that bigger tokamaks would require a much stronger magnetic-field "bottle" to confine the superhot plasma that fusion requires. But the new simulation indicates that the task could be easier than previously supposed. Still, the fusion era remains more than a decade in the future.

■ People with high cholesterol are at risk of developing atherosclerosis. Many try to prevent this outcome by taking cholesterol-reducing drugs. But those who can't may be able to ward off hardening of the arteries by gulping vitamin E and aspirin. In experiments with mice at the University of Pennsylvania School of Medicine, the combination reduced the production of plaque in blood vessels by more than 80%, according to a report in the Oct. 16 *Circulation*, published by the American Heart Assn.

SPEEDIER WAYS TO SPOT BIO SCARES

SCIENTISTS ARE SCRAMBLING FOR BETTER WAYS TO DETECT ANTHRAX BACTERIA BECAUSE existing tests can take hours if not days. Mayo Clinic and Roche Diagnostics Corp. have just announced a test that spots the genetic fingerprint of anthrax within an hour of a

sample's arrival at a lab. Pretty good, but researchers at Georgia Institute of Technology and Emory University aim to bypass labs and produce results in the field. Just drop a sample in a test tube containing a DNA-sensitive chemical, and the liquid will turn blue in only 45 minutes if anthrax is present, says Dr. Anthony F. Holler, CEO of ID Bio-medical Corp. in Vancouver, Canada. ID has applied the technology in a test for another microbe, antibiotic-resistant staph bacteria. In a couple of years, the Georgia group wants a kit that constantly monitors the air for multiple biochemical-warfare agents.

Meanwhile, at the University of North Texas, biologist Guenter W. Gross aims to build within six months the first prototype of a hybrid sensor combining living cells and silicon circuits (photo). Like a canary in a coal mine, the biochip will detect hazards, including biochemical threats. *Geoffrey Smith*

TO CATCH WATER IN A DESERT, WATCH THE BEETLES

HOW DO STENOCARA BEETLES thrive in Africa's Namib Desert, where rain hardly ever falls? By milking the early morning fog that briefly flows in from the Atlantic a few days a month—using a novel collection system on their backs. People in arid regions have been harvesting fog for water since Roman times, but the beetle's system is much more efficient than even the newest man-made collectors, according to

Oxford University zoologist Andrew R. Parker and Chris Lawrence, a researcher at QinetiQ Ltd., the commercial arm of Britain's defense-research agency.

The hard sheath over the beetle's wings has a waxy surface dotted with tiny non-waxy bumps. These hydrophilic, or water-loving, bumps grab moisture from the air. When a droplet grows larger than a bump and touches the slippery sur-

roundings, it rolls off, down to the beetle's mouth. One way to duplicate the beetle's technique would be to print little water-loving dots on water-repellent tent materi-

als, the researchers suggest in the Nov. 1 issue of *Nature*. More sophisticated materials might boost the efficiency of dehumidifiers and air conditioners.

STENOCARA: Its wings inspired new materials





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COCOA WORKERS

Chocolate makers will now monitor their suppliers in Africa

ers have begun outside labor auditing, while Cambodia's apparel firms have agreed to 10 inspections in exchange for higher U.S. export quotas. "It's hard to have people poking their noses into a private business, but we have come to accept that labor standards are good for the economy and the people of Cambodia," says Roger Tan, secretary-general of Cambodia's Garment Manufacturers' Assn.

FILLING THE GAP. What's happening here is that in the absence of action by the WTO, the private sector is slowly drawing up the global economy's labor and environmental standards. So far, more than 240 codes of conduct have been promulgated in the U.S. and Western Europe, according to a survey by the Organization for Economic Cooperation & Development.

Roughly half cover the environment and half emphasize labor rights, requiring companies to adhere to local labor law and to ILO principles such as the right to unionize. Many originate from individual companies and promise no outside oversight. But more than 26 codes mostly those from associations of companies and nonprofit groups, require member firms to allow independent inspections of their facilities or those of suppliers. Since most inspections so far have found at least some problems, the process can be costly to employers.

In the long run, the spread of private-sector standards may force global bodies such as the WTO to step in. As factories and farms are scrutinized by a patchwork of oversight bodies, they may reach a point at which centralized rule would be easier to deal with. Historians point to the U.S. in the 1930s, when Congress created most of the modern regulatory agencies to bring order to a welter of state rules. "The global economy needs a floor of core labor standards," says ILO Director-General Juan O. Somavía. "It could be five years, but labor rules are going to be there."

The Cambodian experiment offers the closest example so far of the sort of enforceable standards advocates are pushing.



GLOBAL TRADE

DO-IT-YOURSELF LABOR STANDARDS

While the WTO dickers, companies are writing the rules

There aren't likely to be many breakthroughs at the World Trade Organization meeting, which began in Qatar on Nov. 9. Even if the WTO can overcome security fears and conflicting agendas, it won't get near an agreement about global labor and environmental standards—two sticking points that have blocked a new trade round since the 1999 fiasco in Seattle.

Yet as governments continue to squabble, outlines for some standards are taking shape. The movement is being driven by Western corporations and the factories in developing countries that supply them. Spurred by incessant complaints from consumer and human

rights groups, more companies are deciding they have little choice but to commit to some sets of standards under debate at the WTO (table, page 76).

Employers in several developing countries are even asking for independent monitoring of their factories to attract or retain orders from Western companies. Their requests have thrust the International Labor Organization (ILO) into a new role as factory-labor cop. Bangladesh clothing makers have agreed to expand an ILO child-labor inspection program to include other basic workplace rights, such as prohibitions against forced labor and the freedom to form unions. Philippine garment mak-

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ing the WTO to create. In 1999, the Clinton Administration signed a three-year trade pact that grants up to 14% annual increases in the U.S. quota of garment imports from Cambodia if the Cambodians meet the ILO's core labor standards. Although the process has led to strikes, angering some employers, the Cambodian government has made inspections mandatory for any garment factory that wants to export to the U.S.

Despite the turmoil, most local factory owners see the costs as worthwhile, says association head Tan. The ILO, which had never conducted factory inspections other than for child labor, hired seven Cambodians and gave them three months of training. The first inspections took place in June, and the ILO now is working with employers to get them to correct problems they found, including excessive overtime. The Bush Administration hasn't yet decided whether to renew the program when it expires in December. But Tan says Cambodian firms want to continue either way to satisfy the labor codes of Western apparel companies.

WILLING PARTICIPANTS. As such codes proliferate, employers in other low-wage countries are starting to see a competitive edge in enforceable labor standards. About 70% of the 1,000 garment factories in the Philippines have been inspected this year by outside labor audi-



tors under a program the industry initiated. Now, the Employers' Confederation of the Philippines is working to include all industries as a way to compete with lower-cost countries, says President Donald Dee. "We want to make it clear in everyone's mind that if they buy Philippine products, they know they're not made in a sweatshop," says Dee.

In Bangladesh, the garment makers' association has agreed to allow the ILO to monitor its 2,000-odd member factories for adherence to the agency's core labor rules. The plan builds on a partially suc-

cessful child-labor program the ILO has run since 1996, which removes children from the factories and helps them enroll in school.

Meanwhile, the drumbeat of pressure from anti-sweatshop campaigns in the U.S. and Europe is driving an increasingly diverse array of industries to embrace emerging standards schemes. Western companies that sell bananas, chocolate, coffee, and timber have agreed to independent oversight of the farms in developing countries that produce their raw materials. Like most garment makers, they have done so only after getting hit with charges of environmental or labor abuses.

On Oct. 1, for example, the U.S.-based Chocolate Manufacturers Assn. (CMA) and British chocolate maker Penned a pact with anti-slavery group and the ILO to monitor cocoa farms after media exposés of child slavery in West Africa. The British group and the CMA, which represents companies such as Hershey Foods Corp. and Mars Inc. pledged an initial \$2 million. But "it may be that, down the pike, global labor standards through international organizations like the WTO will make more sense" than private efforts, says CMA President Larry Graham.

Of course, private labor and environmental rules are still in their infancy. Inspectors often don't know what they're doing. And companies can't respect rights such as freedom of association in repressive countries such as China. Still, the movement seems likely to keep expanding, no matter what happens in Qatar.

By Aaron Bernstein in Washington

INSPECTED

If Cambodian factories pass muster, exports to the U.S. rise

HOW GLOBAL STANDARDS ARE TAKING SHAPE

While the World Trade Organization is deadlocked over labor and environmental standards, more than 240 companies or industry associations now have agreed to abide by a patchwork of new rules. More than 25 of these efforts involve independent monitoring

INDUSTRY GROUPS

► Three human rights groups have linked with industry players, mostly in garments and shoes, to inspect members' factories: Britain-based Ethical Trading Initiative; Fair Labor Assn. in the U.S.; and U.S./European Social Accountability International.

► U.S.-based Workers Rights Consortium monitors factories that make clothes with university logos; under pressure from Europe's Clean Clothes Campaign, garment companies are improving factory conditions.

COUNTRIES

BANGLADESH International Labor Organization (ILO) monitoring of child labor in garment industry is expanding to include other labor standards.

CAMBODIA ILO inspects garment factories under trade pact giving participating companies higher U.S. quotas.

PHILIPPINES Monitors are policing 1,000-odd garment factories, a program now widening to other industries.

COMMODITIES

Western companies in bananas, chocolate, coffee, and timber have agreed to external inspections of farms and other operations around the globe.

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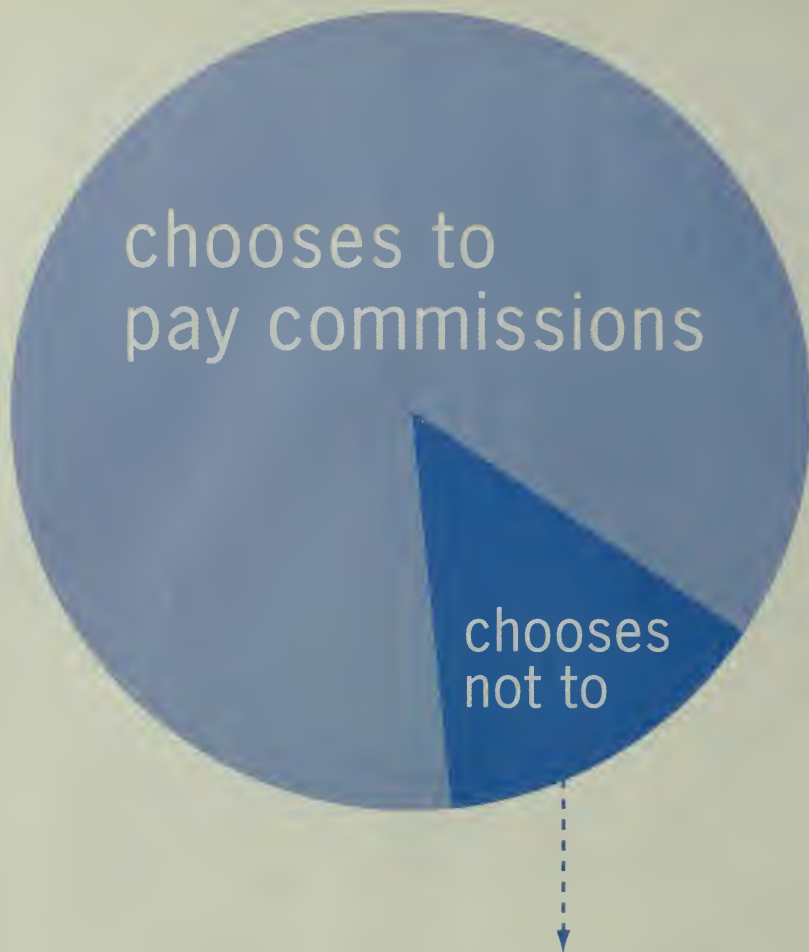


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IMMELT: "There are some real opportunities there"

TELEVISION

AT GE, NEW PRIDE IN THE PEACOCK

CEO Immelt has big plans for NBC beyond the Telemundo buy



For most of the 15 years that General Electric Co. has owned NBC, rumors have swirled that the network was for sale. There were some close calls: Paramount, under CEO Martin S. Davis, came close to striking a deal in the early 1990s. Walt Disney Co. almost became NBC's partner. Then Ted Turner made overtures, and Barry Diller made two subsequent runs at the network. Talks broke down over one issue or another, but NBC continued to be fodder for deal prognosticators.

Then came the announcement on Oct. 1 that NBC was paying \$2 billion in cash and stock for Spanish-language TV network Telemundo. That news all but quelled any notion that GE is looking to cut the Peacock Network loose. Acquisitions by NBC are rare, and the Telemundo deal, which includes taking on an added \$700 million in Telemundo's debt, is the priciest in NBC's 61-year

history. So the deal sent a loud and clear signal from new GE CEO Jeffrey R. Immelt, successor to recently retired Jack Welch: The conglomerate's only media unit will be getting some care and feeding. "I don't see NBC as an eroding asset," Immelt told *BusinessWeek*: "There are some real opportunities there."

Immelt says he is ready to green-light more deals to help jumpstart revenue growth across all of NBC's properties. The network's revenues have doubled in 15 years, to \$6 billion, not quite on par with

TUNING IN
Viewership is up 7% thanks to stalwarts such as *Friends* and new hits such as *Scrubs*

NOT FOR SALE

General Electric says it's committed to keeping and developing NBC. Here's what's in store:

- Buying No. 2 Spanish-language network Telemundo lets NBC tap into the fast-growing Hispanic market to promote its other brands
- NBC will look to add to its family of 24 stations, which includes 11 from Telemundo
- Producing more of its own prime-time dramas and comedies would cut hefty fees paid to outside studios
- News assets, including NBC News, MSNBC, and CNBC, might be expanded by acquiring other properties

Data: *BusinessWeek*

some of GE's other units. "Jeff is on the warpath for growth, and he's being extremely supportive," says NBC CEO Robert C. Wright, who was elevated last year to GE vice-chairman.

LARGER SLICE. What's more, Immelt seems determined to keep NBC in the fold as part of his overall vision of GE as an information-driven company. A cable company or a movie studio doesn't interest him, but more cable channels do, and, he says, "I would like to get more stations." That and other investments could help expand NBC's portion of GE. The network's revenues account for just 5% of the parent's \$130 billion in total sales.

Immelt's approach is certain to be liberating for NBC, which Welch kept under tight rein, especially when it came to dealmaking that might dilute earnings. "Jack liked having the network, for sure, but

he certainly laid down the law on what it could and couldn't do," says an ex-NBC exec. After the 1997 football season, for example, Welch refused to pay the billions to keep NBC's NFL contract. Welch also faced pressure from investors concerned that NBC wasn't a good fit as the lone media asset in a vast conglomerate. So Welch kept NBC on the sidelines of last decade's megamergers, making smaller investments instead in cable channels such as A&E, American Movie Classics, and Bravo. His boldest moves were internal, launching business channel CNBC in 1989 and all-news channel MSNBC with Microsoft Corp. in 1996. It cost NBC about \$500 million to get both networks up and running, including buying FNN and folding it into CNBC.

By most accounts, Immelt got lucky with his first deal as CEO. The price tag for Telemundo and its 11 stations, say sources, was \$1 billion less than when a

bid was first discussed six months earlier, due to the weakening ad market. Even so, NBC beat out rival bidders Viacom and Spanish Broadcasting System Inc. for the No. 2 Latin network in the U.S. after Univision. Telemundo reaches 88% of the 35 million Hispanic TV viewers in the U.S., a market that is expected to grow to 43 million by 2010. And even



though \$2 billion is the most NBC has ever paid for an asset, Wright predicts that the deal won't end up diluting earnings. That's partly because of changes in accounting rules that will no longer require companies to reduce earnings by amortizing goodwill, the excess of a purchase price over an acquired company's net assets.

As at most media companies, though, times are tough at NBC. Ad revenues are expected to drop 6% this year, to \$5.6 billion, vs. 2000, excluding last year's one-time gain from the Olympics. Still, viewership at NBC is up 7% since the start of the fall season, thanks to such stalwarts as *Friends*, *West Wing*, and *Frasier*, and healthy ratings for newcomers *Crossing Jordan* and *Scrubs*. Most network audiences are down. And the Winter Olympics in Salt Lake City in February promise big numbers (box).

Even as the ad climate worsens, NBC, with its new acquisitiveness, may find some bargains. Network President Andrew R. Lack and Chief Financial Officer Mark W. Begor have been chatting with investment bankers about available properties. They're said to be eyeing assets of the TV-production unit that Sony Corp. is shutting down. NBC

owns just two of its prime-time shows, *Will & Grace* and *Providence*, and owning more prime-time fare would lower the fees it pays other TV studios for shows. Another target: local TV stations, which can be cash cows. Regulators are looking at loosening station-ownership restrictions for networks just as the poor economy has many cash-strapped smaller station groups looking to sell. Wright says he is interested in exercising an option in February to up NBC's 32% to a majority stake in Paxson Communications Corp., owner of network PAX TV and 65 stations.

On the news side, Wright says he'd like to add to MSNBC and CNBC. Some analysts figure that means taking a stake in a news service such as Reuters Group or Bloomberg, or even Dow Jones, parent of *The Wall Street Journal*, which co-owns CNBC's operations in Asia and Europe and shares content and revenue with CNBC in the U.S. Wright declined to comment on specifics. But clearly, he and other NBC execs have a new boss who sees the benefits of Big Media—and figures NBC can't help GE long term if it doesn't gain some heft.

By Tom Lowry, with Diane Brady, in New York

LET THE EXTREME SELL BEGIN



These aren't the typical Olympic ad spots—featuring a pixie Dorothy Hamill skating on double axels. Instead, NBC is pitching this February's Winter Olympics with hard-charging NASCAR race driver Rusty Wallace, with a downhill skier's hair dyed to resemble leopard's spots, and a pair of curvaceous bobsledders brazenly call themselves "the fastest on ice."

As the Salt Lake City games approach, NBC is seeking gold by luring the most fickle—and most coveted—viewers: the 18- to 34-year-old men, who have been defecting from sports programming for years. This year the network is investing its \$25 million on-air promotion budget to reach that hipper, younger audience. The stakes are high for NBC,





3.5 billion to air Olympic Games in 2008. But ratings among younger viewers fell during last Sydney Summer Olympics by more than 50 percent and during the Nagano Winter Olympics by 40%. NBC lost the network millions in discounted "make-good" ads. At the same time, NBC figures its audience is much larger in the aftermath of Sept. 11. "People want a pro-American, patriotic event," says John Egan, co-president of the NBC Agency,

AERIAL DYNAMICS

NBC's thrill ads for the Olympics are aimed at coveted young viewers

its in-house ad agency. "And games in America go better" than those in far-off places such as Australia, where time differences preclude airing real-time events. NBC will also step up red-white-and-blue-laden spots after the November sweeps, says Vince Manze, Miller's co-president. And the promos will have an extreme-sports quality about them, such as one in which U.S. women's hockey team captain Cammi Granato is shown mowing down a young figure skater. "Winter Olympics is all about

speed," says Randy Falco, COO of NBC Olympics. "We're trying to capture some of that speed and excitement."

NBC, which launched the Olympic campaign during last spring's National Basketball Assn. playoffs, intends to plaster ads during a Saturday teen comedy block that it says outdraws MTV. It will also place ads on its youth-oriented gross-out show *Fear Factor*. And NBC is freeing up spots on its pricey Thursday-night lineup of shows such as *Friends* and *Will & Grace*. It will advertise in movie theaters as well as on sister cable channels CNBC and MSNBC, which will also air some Olympic events. Even so, the blitz is "a long shot to bring the younger viewers in" because they have so many entertainment options, says Roy Rothstein, director of national broadcast research at media-buying firm Zenith Media Services Inc. Zenith hasn't decided whether to buy Olympics spots for clients such as Verizon Communications and Toyota Motor Corp. And it may take more than the "fastest girls on ice" to draw in younger male viewers.

By Ronald Grover in Los Angeles

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THERE'S BAD NEWS, AND THERE'S...BAD NEWS

Earnings suffered their biggest drop in 25 years—and the situation is likely to get worse

The forecast called for recovery in the fall. Then came September 11. Now the corporate damage assessment is in: Third-quarter earnings for the 900 companies on *BusinessWeek's* Corporate Scoreboard plunged a breathtaking 55% from a year earlier. That was the worst drop in the

25 years of *BusinessWeek's* quarterly Scoreboards, eclipsing the second quarter's 52% decline. Margins were sliced by more than half, to 3% from the 6.8% return enjoyed by the group a year earlier. All this in a quarter in which revenues were surprisingly flat—up 1% in the third quarter from a year earlier.

And if you think this marks the bottom, brace yourself. Charles L. Hill, director of research at First Call/Thomson Financial, estimates that earnings for companies in the narrower Standard & Poor's 500-stock index, which dropped an estimated 20% in the third quarter, will decline another 20% in the fourth.

Winners and Losers in Quarterly Profits

INDUSTRIES

LEADERS		LAGGARDS	
PERCENTAGE CHANGE FROM 2000'S THIRD QUARTER		PERCENTAGE CHANGE FROM 2000'S THIRD QUARTER	
DRUG DISTRIBUTION	109%	TELECOMMUNICATIONS	LOSS
SAVINGS & LOAN	64	SEMI CONDUCTORS	LOSS
CONSTR. & REAL ESTATE	60	AIRLINES	LOSS
PETROLEUM SERVICES	54	ELECTRONICS	LOSS
AEROSPACE & DEFENSE	53	COMPUTERS & PERIPHERALS	LOSS
FOOD DISTRIBUTION	46	STEEL	LOSS
HEALTH-CARE SERVICES	43	CARS & TRUCKS	LOSS
ALUMINUM	31	ENTERTAINMENT	LOSS
CONSTR. & ENGINEERING	22	BROADCASTING	LOSS
MEDICAL PRODUCTS	10	FOREST PRODUCTS	LOSS
DRUGS & RESEARCH	10	INSTRUMENTS	LOSS
EATING PLACES	3	NONFERROUS METALS	LOSS
FOOD PROCESSING	2	INDUSTRIAL DISTRIBUTION	LOSS
TOBACCO	1	AUTO PARTS	-91%
BANKS—MIDWEST	0	CHEMICALS	-87

ALL-INDUSTRY AVERAGE: -55%

COMPANIES

WHO MADE THE MOST		WHO LOST THE MOST	
MILLIONS OF DOLLARS		MILLIONS OF DOLLARS	
GENERAL ELECTRIC	\$3,281	LUCENT TECHNOLOGIES***	-\$7,329
EXXON MOBIL	3,180	AGERE SYSTEMS***	-3,354
CITIGROUP	3,177	AT&T	-2,206
PHILIP MORRIS	2,328	MDT/DRLA	-1,408
PFIZER	2,072	JDS UNIPHASE*	-1,224
SBC COMMUNICATIONS	2,072	UAL	-1,159
MERCK	1,948	AOL TIME WARNER	-996
VERIZON COMMUNICATIONS	1,883	EMC	-945
WAL-MART STORES**	1,622	US AIRWAYS GROUP	-766
IBM	1,595	FORD MOTOR	-692
JOHNSON & JOHNSON	1,529	NEXTEL COMMUNICATIONS	-619
TYCO INTERNATIONAL***	1,380	ENRON	-618
FANNIE MAE	1,364	ST. PAUL	-595
MICROSOFT*	1,283	MICRON TECHNOLOGY***	-576
BRISTOL-MYERS SQUIBB	1,231	LEVEL 3 COMMUNICATIONS	-531

*Fiscal First Quarter

**Fiscal Second Quarter

***Fiscal Fourth Quarter

Data: Standard & Poor's COMPUSTAT



when the full economic brunt of the September 11 tragedy hits. What's more, Hill thinks the downward trend could stretch as far as next year's third quarter: "Investors need to put on their hard hats, because they're going to be bombarded with earnings warnings over the next several months."

Indeed, while some economists believe the economy could stabilize as soon as the spring, as rate cuts—including the Federal Reserve's half-point reduction on Nov. 6—and congressional tax cuts kick in, Wall Street forecasters say the turnaround in profits could take longer. The reason: Many service-sector companies that were betting the economy would rebound by now are finally biting the bullet and paring back. That means more layoffs, more restructurings—and more of the special charges that eat into profits. As a result, it might be years before companies match their record earnings of last year. You can't jump back to 2000-level earnings unless growth snaps back to 5% or 6%, and that isn't likely to happen for quite a while," says Salomon Smith Barney Inc. economist Steven Wieting.

DEFENSE PROFITS. The third quarter—marked by a 0.4% fall in gross domestic product—was so bleak that success became relative. General Electric Co. claimed honors as the earnings champ with a mere 3% rise in profits, to \$3.28 billion. Meanwhile, the second-quarter leader, Exxon Mobil Corp., saw its earnings plunge 29%, to \$3.18 billion, with the collapse in oil prices. What does GE have that Exxon doesn't? Diversification. Despite suffering \$400 million in insurance losses related to the terrorist attacks—its Employers Reinsurance unit covered part of the World Trade Center and at least some of the lost airplanes—GE says it managed to keep profits up with continued growth in its power-systems, medical-systems, and financial-services units. "At times like this, the di-

versity of our portfolio really matters," says Chairman and Chief Executive Jeffrey R. Immelt.

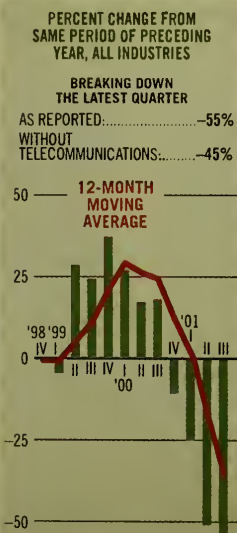
But GE was an exception. Barely 400 companies in *BusinessWeek's* survey turned in higher profits, while nearly 500 either lost money or saw earnings drop. Of the 66 industry sectors tracked by *BusinessWeek*, only 15 had higher profits than a year ago. Among them were defense contractors, the construction industry, and four health-care sectors. Drugmakers, for example, enjoyed a collective 10% rise in earnings on an 11% jump in sales. The strongest gains there came from Pfizer Inc., whose profits rose 52%, to \$2.07 billion, on the strength of its chole-

sterol-lowering drug, Lipitor. And Stephen M. Scala, an analyst at SG Cowen, expects the big drugmakers that he follows to boost earnings by 13% in 2002.

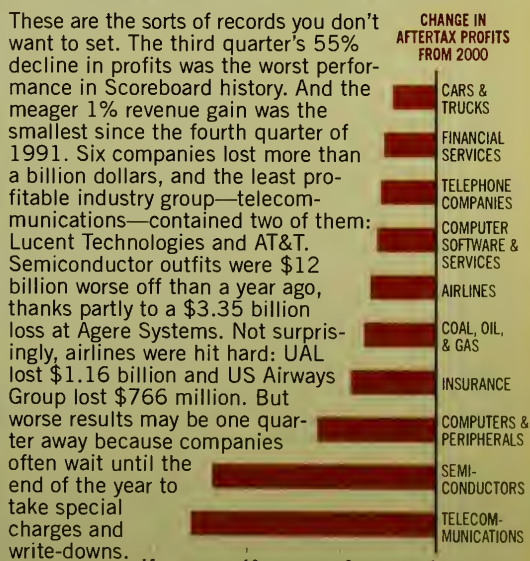
The tech and telecom sectors, which began losing altitude last year, remained the biggest drag on profits. Chipmakers, stung by slowing demand for PCs and a bitter price war between Intel and Advanced Micro Devices, lost \$7.2 billion, while Motorola, Avaya, and other electronics makers were collectively \$1.9 billion in the red. The biggest loser among the 900 Scoreboard companies was Lucent Technologies, which posted an outsized loss of \$7.33 billion—reflecting write-offs and one-

A Spotlight on Third-Quarter Profits

AFTERTAX PROFITS QUARTER BY QUARTER



INDUSTRIES WITH THE BIGGEST DOLLAR CHANGE IN THE QUARTER



Data: Standard & Poor's COMPUSTAT

Corporate Scoreboard

time charges—and a 28% drop in revenues, to \$5.16 billion, as demand for telecommunications equipment continued to wither.

The pain in the telecom sector is now spreading to the Bell operating companies. While their local monopolies traditionally insulated them from recession, the Bells are feeling the pinch from the decline in the Internet sector. The number of local-access lines has slipped 1.3% industrywide since the third quarter of 2000, and growth in such services as high-speed Net access and network management that were supposed to pick up the slack is slowing sharply. BellSouth's earnings were wiped out by a \$1 billion write-off of its 3% stake in data-carrier Qwest Communications International, while SBC Communications' profits dropped 31%, to \$2.07 billion.

Few industries, though, are suffering more than the airlines. They were hit with rising labor costs and slowing



traffic even before the terrorist hijackings, and many analysts now expect a brutal shakeout marked by bankruptcies and mergers. UAL Corp., the parent of United Airlines, lost a record \$1.16 billion in the third quarter. Likewise, at Delta Air Lines Inc., which lost \$259 million, "recovery is not visible at this point," warns President Frederick Reid.

If there's a glimmer of good news, it's that some industries that were devastated in the last recession appear bet-

ter positioned this time. Salomon Wieting notes that despite rising loan losses, the banking sector has held up well. Meanwhile, many heavy manufacturers began slashing costs more than a year ago, sharply lowering their break-even points. True, U.S. auto makers, which historically lose billions during recessions, are struggling: DaimlerChrysler and Ford Motor Co. are both headed for full-year losses. But General Motors Corp. says aggressive cost-cutting will keep it profitable in the fourth quarter—and even in 2002, when U.S. auto sales are projected to drop 7%. "We won't generate a lot of cash, but we'll hold our own," vows GM Chief Financial Officer John M. Devine. He still expects GM to earn \$275 million in the fourth quarter, vs. \$89 million a year ago. As the recession deepens, just remaining profitable in coming quarters may be a feat in itself.

By Dean Foust and Aixa M. Pascual in Atlanta, with bureau reports

CAN UNCLE SAM MOVE THE BOTTOM LINE?

As profits disappear, Washington is determined to ante up a stimulus package to help get growth going again. But while the measures Congress is considering would give money to consumers and boost corporate cash flow, they probably won't spur the economy enough to make a big difference in the profits of most corporations.

There are two parts to the fiscal-stimulus plan that was passed by the House last month and has a good chance of becoming law. The part that's aimed at consumers could include a tax rebate for low-income workers—perhaps \$14 billion in total—and an acceleration of income-tax cuts passed earlier this year. On the corporate side, the legislation would offer companies accelerated depreciation on their capital spending. That could cut corporate tax payments by as much as \$39 billion in 2001, according to the Congressional Joint Committee on Taxation.

SMALL BOUNCE. The individual tax cuts could jump-start the profits of consumer companies—if Americans actually spend the money they save on their tax bills. But that's not what happened with the \$38 billion tax cut approved in the spring, and the environment has worsened since then. "Everybody expected [the last tax

cut] to create a big bounce in back-to-school spending," says Dan Niles, a tech analyst at Lehman Brothers Inc. But even before September 11, the stock market was sagging, as it became clear that households were socking away the money rather than spending it. Indeed, the personal savings rate jumped from 1% in June to almost 5% in September.

Similarly, the tax proposal could provide more business for capital-equipment providers, giving the economy a bit more juice. "It could tip the decision to drill a marginal well," says Jon W. Sauer, vice-president for corporate taxation at Apache Corp., a Houston-based oil producer.

But with factories and plants running at 76% of capacity in September, down from 82% a year earlier, most companies will be reluctant to spend even with the new tax breaks. That's especially true in the beleaguered telecom industry, which was one of the biggest capital spenders of the 1990s. In that industry, companies

are jealously guarding their cash in hopes of surviving the continuing falloff in demand. "The package is better than nothing, but it's not going to generate the kind of investment that will yield the productivity gains we've had in the past," says Mary C. Farrell, senior investment strategist at UBS PaineWebber Inc.

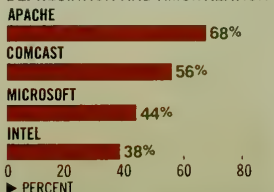
The accelerated-depreciation proposal won't have much effect on the net income of companies that take advantage of the new breaks, because they will continue to use slower depreciation when they report to shareholders. An additional \$13 billion could be added to the bottom line of U.S. companies if Congress repeals the alternative minimum

tax on corporate profits and extends operating-loss carrybacks. But with profits at major corporations falling by \$50 billion in the third quarter alone, tax cuts like these are a drop in the bucket. Only the revival of the U.S. economy can ensure a full-fledged profits recovery.

By Margaret Popper in New York

GETTING A BOOST FROM THE STIMULUS BILL

Faster writeoffs could cut taxes for companies with big capital budgets



*AS PERCENTAGE OF COST OF GOODS SOLD, SECOND QUARTER 2001
Data: ISI Group

Third Quarter 2001

CORPORATE SCOREBOARD

Glossary

SALES: Includes all sales and other operating revenues. For banks, includes all operating revenues.

PROFITS: Net income before extraordinary items. For banks,

profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available

for common stockholders (most recent 12 months) to latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on Nov. 1, 2001, common-

stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
ALL-INDUSTRY COMPOSITE	1903752.8	1	5825424.7	7	57989.9	-55	171254.5	-54	3.0	6.8	7.5	39	0.84
AEROSPACE & DEFENSE													
INDUSTRY COMPOSITE	40296.0	15	118766.7	12	1687.6	53	6242.4	47	4.2	3.2	15.8	15	3.05
ALLIANT TECHSYSTEMS ATK ⁽⁹⁾	427.6	57	1146.7	35	19.3	20	56.5	17	4.5	5.9	35.6	27	3.38
BOEING BA	13687.0	15	42496.0	16	650.0	7	2726.0	66	4.7	5.1	28.4	9	3.81
GENERAL DYNAMICS GD	3020.0	21	8655.0	13	230.0	-22	697.0	2	7.6	11.8	21.7	19	4.53
GOODRICH GR	1051.9	13	3131.7	14	80.2	36	221.9	33	7.6	6.3	21.3	8	2.78
LOCKHEED MARTIN LMT	6384.0	7	17355.0	-2	249.0	NM	498.0	NM	3.9	NM	8.7	31	1.59
NEWPORT NEWS SHIPBUILDING NNS	578.0	17	1639.0	10	27.0	29	72.0	9	4.7	4.3	31.6	23	3.03
NORTHROP GRUMMAN NOC	3605.0	108	9254.0	72	117.0	-22	334.0	-31	3.2	8.7	8.6	17	5.96
PRECISION CASTPARTS PCP ⁽⁹⁾	661.5	17	1930.3	16	12.1	-61	92.0	7	1.8	5.4	12.7	10	2.26
RAYTHEON RTN	3961.0	-5	12236.0	-2	-262.0	NM	-48.0	NM	NM	3.2	1.3	83	0.41
UNITED TECHNOLOGIES UTX	6920.0**	7	20923.0	6	565.0	14	1593.0	15	8.2	7.7	23.6	13	3.98
AUTOMOTIVE													
INDUSTRY COMPOSITE	108774.6	-5	347429.7	-7	-181.8	NM	1086.4	-91	NM	2.1	3.0	49	0.43
A) CARS & TRUCKS													
GROUP COMPOSITE	82516.7	-5	263198.4	-6	-248.0	NM	970.8	-90	NM	2.2	4.0	38	0.62
FORD MOTOR F	36552.0	-9	121312.0	-5	-692.0	NM	-385.0	NM	NM	2.2	4.9	45	0.36
GENERAL MOTORS GM	42475.0**	-1	131318.0	-5	385.0	-54	1220.0	-72	0.9	1.9	3.7	29	1.47
NAVISTAR INTERNATIONAL NAV ⁽²⁾	1575.0	-18	4852.0	-25	2.0	-98	-30.0	NM	0.1	5.0	-10.6	NM	-2.27
ISHKOSH TRUCK OTRK8 ⁽³⁾	413.6	15	1163.8	7	17.6	21	42.6	2	4.3	4.1	14.7	13	3.05
VEICAR PCAR	1501.1	-15	4552.6	-27	39.4	-58	123.2	-68	2.6	5.2	8.3	22	2.43
B) PARTS & EQUIPMENT													
GROUP COMPOSITE	22318.3	-8	72841.0	-10	42.2	-91	118.7	-96	0.2	2.0	1.5	80	0.21
AMERICAN AXLE & MFG. HOLDINGS AXL	743.5	10	2315.6	-1	25.5	5	83.5	-20	3.4	3.6	21.2	8	2.25
DELPHI ALV	907.7	-5	3021.2	-3	-29.5	NM	21.4	-86	NM	4.1	2.1	37	0.43
FORGEWARNER BWA	559.9	-9	1768.8	-14	18.4	254	64.2	-26	3.3	0.8	6.5	16	2.71
GOODYEAR TIRE & RUBBER CT8	791.5	-6	2378.1	-10	14.4	-39	36.3	-60	1.8	2.8	4.5	23	0.59
JOHN DEERE DCN	2497.0**	-14	8047.0	-19	13.0	-55	0.0	NM	0.5	1.0	-3.5	NM	-0.57
DELPHI AUTOMOTIVE SYSTEMS DPH	6229.0	-6	19708.0	-11	26.0	-82	-239.0	NM	0.4	2.2	-1.2	NM	-0.07
DURA AUTOMOTIVE SYSTEMS DRRA	568.9	-3	1897.1	-4	-3.4	NM	18.7	-51	NM	1.7	5.0	7	1.25
TRATON ETN	1750.0	-13	5604.0	-12	40.0	-42	139.0	-54	2.3	3.4	8.0	23	2.81
TRACORP GY ⁽¹⁾	356.0	37	1119.0	45	5.0	-74	25.0	-48	1.4	7.3	14.6	16	0.75
VEAR LEA	3106.7	-1	10219.7	-5	23.0	-40	83.0	-59	0.7	1.2	9.7	13	2.39
MOORE MFG. MODI ⁽⁹⁾	269.1	-5	806.5	-7	6.8	-66	21.6	-60	2.5	7.2	5.3	24	0.86
TRINTECO AUTOMOTIVE TEN	817.0	-6	2606.0	-3	-2.0	NM	-31.0	NM	NM	0.7	-38.8	NM	-2.57
TRISTEON VC	3722.0	-15	13350.0	-11	-95.0	NM	-104.0	NM	NM	1.1	-5.7	NM	-1.48
C) TIRE & RUBBER													
GROUP COMPOSITE	3939.6	1	11390.3	-2	23.9	-32	-3.1	NM	0.6	0.9	-2.4	NM	-0.51
GOODYEAR BDG	261.7	-3	715.7	-4	14.6	-18	26.5	-42	5.6	6.6	8.6	13	1.99
GOODYEAR TIRE & RUBBER GT	3677.9	2	10674.6	-2	9.3	-45	-29.6	NM	0.3	0.5	-4.0	NM	-0.84

(1) Third quarter ended Aug. 31. (2) Third quarter ended July 30. (3) Fourth quarter and most recent nine months ended Sept. 30. (4) Fourth quarter and most recent nine months ended Aug. 31. (5) Fourth quarter and most recent nine months ended July 31. (6) First quarter and most recent nine months ended Sept. 30. (7) First quarter and most recent nine months ended Aug. 31. (8) First quarter and most recent nine months ended July 31. (9) Second quarter and most recent nine months ended Sept. 30. (10) Second quarter and most recent nine months ended Aug. 31. (11) Second quarter and most recent nine months ended July 31. Sales include excise taxes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 2 months, not necessarily for end of most recent fiscal year; they include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful.

Data: Standard & Poor's COMPUSTAT

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO 11-1	12 MONTH EARNINGS PER SHARE
	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 %	3QO QUARTER 2000 %			
3 BANKS													
INDUSTRY COMPOSITE	82768.9	-10	256197.0	-4	8198.5	-28	27484.7	-12	9.9	12.4	11.6	18	1.97
(A) BANKS - EAST													
GROUP COMPOSITE	26466.2	-12	82496.5	-8	2694.4	-29	7790.1	-35	10.2	12.7	11.9	19	1.91
ASSOCIATED BANC-CORP ASBC	265.6	-6	820.3	-1	45.1	9	133.2	4	17.0	14.7	16.0	13	2.60
BANK OF NEW YORK BK	1745.0**	-8	5415.0	-2	243.0	-33	1012.0	-4	13.9	19.2	21.4	18	1.86
BANKNORTH GROUP BKNG	366.7	-7	1126.2	-1	62.2	3	177.5	37	17.0	15.4	16.4	13	1.71
FLEETBOSTON FINANCIAL FBF	4959.0	-22	15293.0	-23	766.0	-21	1438.0	-52	15.4	15.2	11.2	16	2.13
J.P. MORGAN CHASE JPM	12399.0	-16	39973.0	-9	449.0	-68	2026.0	-60	3.6	9.4	7.2	25	1.48
M&T BANK MTB	642.1	29	1959.9	35	97.9	32	276.3	29	15.2	14.9	11.8	19	3.50
MBNA KRB	2600.6	28	7192.6	27	478.3	30	1169.5	32	18.4	18.1	22.6	16	1.87
NORTH FORK BANCORPORATION NFB	306.3	2	908.5	6	84.9	17	241.5	50	27.7	24.3	23.6	14	1.94
PNC FINANCIAL SERVICES GROUP PNC	1769.0	-7	5441.0	-5	298.0	0	858.0	-5	16.8	15.7	16.8	14	3.97
STATE STREET STT	1413.0**	-5	4367.0	0	170.0	13	458.0	2	12.0	10.0	15.9	25	1.83
(B) BANKS - MIDWEST													
GROUP COMPOSITE	26237.4	-6	79244.8	-1	3355.9	0	8859.4	-3	12.8	12.0	11.4	20	1.60
BANK ONE ONE	6032.0	-13	18736.0	0	754.0	30	2141.0	NM	12.5	8.4	8.0	25	1.38
COMERICA CMA	1017.1**	-14	3205.2	-7	208.5	-3	510.6	-17	20.5	18.1	14.4	12	3.97
FIFTH THIRD BANCORP FITB	1620.9	-2	4946.5	4	279.6	-10	714.9	-13	17.3	18.8	13.5	33	1.75
HUNTINGTON BANCSHARES HBAN	609.3	-7	1872.2	-3	42.6	-16	112.9	-55	7.0	7.7	8.0	21	0.75
KEYCORP KEY	1834.0**	-11	5724.0	-9	249.0	106	331.0	-55	13.6	5.9	9.2	16	1.38
MARSHALL & ILSLEY MI	678.9	-2	2063.7	2	83.3	61	229.2	-1	12.3	7.5	13.1	20	2.90
NATIONAL CITY NCC	2232.7	-2	6903.7	3	356.6	8	1041.5	5	16.0	14.6	18.7	12	2.20
NORTHERN TRUST NTRS	785.9**	-15	2532.8	-3	126.6	3	385.1	7	16.1	13.4	19.4	23	2.20
TCF FINANCIAL TCB	300.8	2	905.8	6	52.9	13	153.1	14	17.6	15.8	22.8	16	2.64
U.S. BANCORP USB	4026.7	-7	12600.0	1	38.7	-95	1011.1	-52	1.0	16.4	8.1	20	0.89
WELLS FARGO WFC	7099.0	3	19755.0	-1	1164.0	42	2229.0	-23	16.4	11.9	12.4	21	1.94
(C) BANKS - SOUTH & SOUTHEAST													
GROUP COMPOSITE	26606.4	-13	83655.4	-4	1812.3	-51	9480.3	7	6.8	12.1	11.3	16	2.50
BANK OF AMERICA BAC	12751.0	-14	40438.0	-7	841.0	-54	4734.0	-23	6.6	12.3	12.2	16	3.76
BB&T BBT	1549.8	15	4728.3	13	222.0	206	695.7	49	14.3	5.4	16.5	16	2.04
FIRST TENNESSEE NATIONAL FTN	664.5**	8	1913.7	12	89.0	35	240.4	49	13.4	10.7	22.6	15	2.38
HIBERNIA HIB	364.5	-3	1129.1	4	57.2	8	162.4	6	15.7	14.1	11.3	14	1.10
NATIONAL COMMERCE FINANCIAL NCF	381.7	-5	1167.8	61	57.6	895	165.4	208	15.1	1.4	6.6	32	0.70
POPULAR BPOP	634.3	-7	1943.5	0	77.2	8	228.3	14	12.2	10.5	14.3	19	1.59
REGIONS FINANCIAL RGBK	1014.0	4	3033.5	6	135.2	6	370.8	-7	13.3	13.2	13.0	12	2.23
SOUTHTRUST SOTR	921.8	-9	2849.0	-2	142.1	17	409.6	14	15.4	12.0	13.6	15	1.56
SUNTRUST BANKS STI	2060.3	-7	6486.6	2	334.1	2	1036.6	8	16.2	14.8	16.7	13	4.69
SYNOVUS FINANCIAL SNV	511.9	5	1549.3	10	78.9	22	226.4	21	15.4	13.3	19.4	23	1.04
UNION PLANTERS UPC	776.4	-3	2391.6	4	112.0	10	327.7	7	14.4	12.8	13.5	13	3.13
WACHOVIA WB	4976.0**	-25	16025.0	-12	-334.0	NM	883.0	NM	NM	12.8	5.4	19	1.50
(D) BANKS - WEST & SOUTHWEST													
GROUP COMPOSITE	3459.0	0	10800.3	8	336.0	-31	1355.0	12	9.7	14.1	15.0	10	2.32
BANCWEST BWE	392.5	0	1243.2	10	63.6	12	191.3	19	16.2	14.5	11.6	18	1.96
PACIFIC CENTURY FINANCIAL BOH	309.3	-6	1032.2	5	31.1	-10	91.5	13	10.0	10.5	9.0	16	1.57
PROVIOIAN FINANCIAL PVN	1538.2	7	4764.9	11	43.3	-78	504.3	15	2.8	13.9	30.1	1	2.50
UNIONBANCAL UB	709.4	-12	2230.4	-5	125.1	-5	349.6	-19	17.6	16.3	10.6	15	2.25
ZIONS BANCORPORATION ZION	509.5	2	1529.5	17	72.8	13	218.3	128	14.3	12.9	12.7	16	3.12
4 CHEMICALS													
INDUSTRY COMPOSITE	27304.9	-6	88011.9	-4	258.5	-87	971.0	-85	0.9	6.6	3.0	68	0.45
AIR PRODUCTS & CHEMICALS APD (3)	1361.7	-6	4275.9	2	150.4	31	377.3	413	11.0	15.1	16.5	18	2.35
CABOT CBT (3)	381.0	-2	1275.0	7	27.0	145	93.0	21	7.1	2.8	12.5	20	1.66
CROMPTON CK	651.9	-12	2113.9	-9	-68.2	NM	-38.5	NM	NM	2.9	-6.2	NM	-0.37
CYTEC INDUSTRIES CYT	342.1	-9	1072.3	-5	21.3	-23	59.4	-41	6.2	7.4	21.3	8	3.22
OOW CHEMICAL DOW	6729.0**	-10	21459.0	-4	57.0	-84	-380.0	NM	0.8	4.8	-1.3	NM	-0.06
OUPONT DD	5641.0**	-12	19497.0	-11	142.0	-75	413.0	80	2.5	8.7	5.3	66	0.65
EASTMAN CHEMICAL EMN	1367.0**	-1	4113.0	5	23.0	-76	87.0	NM	1.7	7.0	-2.1	NM	-0.45
FULLER (H.B.) FULL (1)	315.7	-3	951.2	-5	14.6	97	32.0	-8	4.6	2.3	10.7	16	3.27
GEORGIA GULF GGC	267.4	-27	973.7	-20	2.5	-67	-7.0	NM	0.9	2.0	-14.6	NM	0.46
GRACE (W.R.) GRA	448.1	8	1294.1	7	19.8	-42	57.4	-38	4.4	8.2	NM	NM	-1.92
GREAT LAKES CHEMICAL GLK	380.5	-9	1252.2	-1	-106.6	NM	240.1	NM	NM	8.2	-31.8	NM	4.29
HERCULES HPC	637.0	-22	2009.0	-17	-71.0	NM	-58.0	NM	NM	9.2	-11.1	NM	0.82
IMC GLOBAL IGL	405.9	-17	1432.9	-11	-29.3	NM	14.0	NM	NM	1.6	1.4	NM	0.08
INTERNATIONAL FLAVORS & FRAGRANCES IFF	462.7	36	1424.6	32	33.6	16	86.8	29	7.3	8.5	16.3	32	0.91
LUBRIZOL LZ	462.4	7	1404.9	6	22.8	2	73.3	-14	4.9	5.4	13.5	14	2.05
LYONDELL CHEMICAL LYO †	750.0	-23	2509.0	-19	-67.0	NM	-97.0	NM	NM	13.6	-14.9	NM	1.20
MILLENNIUM CHEMICALS MCH	393.0	-17	1256.0	-8	-12.0	NM	51.0	NM	NM	7.4	-4.3	NM	0.58
MONSANTO MON	936.0	7	4253.0	-2	45.0	NM	401.0	77	NM	NM	5.1	14	2.22

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
OM GROUP OMG	833.3	257	1285.5	96	20.5	10	60.3	15	2.5	8.0	14.3	18	3.27
POLYONE POL	659.6	38	2064.7	74	2.9	480	-16.0	NM	0.4	0.1	-3.7	NM	-0.33
PRAXAIR PX	1271.0	0	3920.0	4	62.0	-49	314.0	-12	4.9	9.6	13.9	25	1.95
ROHM & HAAS ROH	1346.0**	-15	4326.0	-10	53.0	-31	-107.0	NM	3.9	4.9	-1.0	NM	-0.16
SOLUTIA SOI	690.0	-11	2174.0	-11	7.0	-91	42.0	-68	1.0	10.1	NM	NM	-0.41
USEC USU (6)	300.5	32	830.5	-20	-4.7	NM	48.2	NM	NM	2.0	7.2	8	0.85
WELLMAN WLM	272.0	-3	844.6	1	3.0	-66	9.0	-61	1.1	3.2	2.8	24	0.55
CONGLOMERATES													
INDUSTRY COMPOSITE	46342.4	-8	144740.3	-4	2727.6	-29	10360.4	-15	5.9	7.7	18.8	30	1.18
ALLEGHENY TECHNOLOGIES ATI	537.7	-12	1634.9	-13	8.0	-81	20.6	-84	1.5	6.9	2.6	44	0.34
ANIXTER INTERNATIONAL AXE	761.5	-22	2481.6	-6	-11.7	NM	27.9	-56	NM	2.5	7.9	23	1.14
GENERAL ELECTRIC GE	29468.0**	-8	91938.0	-3	3281.0	3	10195.0	11	11.1	9.9	26.4	28	1.37
HONEYWELL INTERNATIONAL HON	5789.0	-7	17799.0	-4	-308.0	NM	-217.0	NM	NM	4.5	0.4	NM	0.04
IKON OFFICE SOLUTIONS IKN (3)	1283.0	-7	3955.4	-4	-41.6	NM	1.1	-99	NM	1.2	1.2	82	0.12
PALL PLL (5)	331.5	-4	957.3	0	25.7	-44	92.4	-24	7.7	13.4	15.3	22	0.95
PEPSIAMERICAS PAS	847.1	29	2409.3	28	32.7	13	80.9	16	3.9	4.4	5.4	25	0.53
TEXTRON TXT	2810.0**	-12	9138.0	-7	-330.0	NM	-91.0	NM	NM	4.9	-7.6	NM	-2.18
TRW TRW	3862.0	-5	12305.0	-6	77.0	141	135.0	-69	2.0	0.8	5.3	33	1.06
VALHI VHI	262.5	-15	827.6	-11	10.3	-21	89.5	53	3.9	4.2	16.9	14	0.93
VIAO VVI	390.1	-9	1294.2	-1	-15.8	NM	25.9	-77	NM	10.3	7.9	30	0.65
CONSUMER PRODUCTS													
INDUSTRY COMPOSITE	90740.2	6	264451.3	6	7992.3	-7	21200.0	-2	8.8	10.0	25.8	24	1.83
(A) APPAREL													
GROUP COMPOSITE	9798.5	3	26672.1	5	584.3	-11	1386.2	-3	6.0	6.9	14.8	16	2.07
BROWN SHOE BWS (11)	442.1	5	1285.9	10	5.8	-37	17.2	-12	1.3	2.2	11.8	6	1.86
COLUMBIA SPORTSWEAR COLM	305.6	24	565.3	25	49.6	30	64.6	43	16.2	15.5	23.8	15	1.95
IONES APPAREL GROUP JNY	1236.0	4	3186.0	0	53.0	-53	205.0	-14	4.3	9.4	13.4	13	2.10
KELLWOOD KWO (11)	501.0	7	1750.7	11	1.8	-72	25.3	-38	0.4	1.4	11.6	9	2.29
LIZ CLAIBORNE LIZ	1008.4	15	2562.0	9	72.6	8	150.6	4	7.2	7.6	20.0	13	3.63
NIKE NKE (7)	2613.7	-1	7267.1	3	204.2	-3	464.3	-4	7.8	8.0	15.9	23	2.14
PHILLIPS-VAN HEUSEN PVH (11)	334.4	2	1075.3	15	7.0	16	14.1	110	2.1	1.8	12.2	7	1.22
REEBOK INTERNATIONAL RBK	847.3	8	2328.2	4	42.2	31	97.6	31	5.0	4.1	15.0	12	1.66
RUSSELL RML	348.8	-2	839.4	-6	-15.4	NM	-24.7	NM	NM	0.1	-2.8	NM	-0.43
SKETCHERS U.S.A. SKX	287.9	40	746.3	48	11.4	-26	45.3	33	4.0	7.4	28.0	8	1.45
TIMBERLAND TBL	396.2	6	842.5	11	48.5	-16	76.5	-8	12.2	15.3	33.7	11	2.85
VF VFC	1477.2	-8	4223.5	-1	103.6	0	250.4	-3	7.0	6.5	11.1	15	2.25
(B) APPLIANCES & HOME FURNISHINGS													
GROUP COMPOSITE	15720.6	5	48991.1	5	182.9	-66	1168.9	-43	1.2	3.6	11.9	29	0.98
BEO BATH & BEYONO BBY (10)	713.6	21	2035.6	26	54.0	24	148.3	29	7.6	7.4	20.2	40	0.64
BEST BUY BBY (10)	4164.0	31	13322.6	28	85.0	10	329.7	5	2.0	2.4	19.0	32	1.81
CIRCUIT CITY GROUP CC (10)	2036.6	-19	7095.3	-16	6.8	-88	118.1	-57	0.3	2.2	2.3	55	0.25
FURNITURE BRANDS INTERNATIONAL FBN	448.7	-10	1414.5	-11	13.9	-41	35.2	-58	3.1	4.7	9.5	21	1.17
HARMAN INTERNATIONAL INDUSTRIES HAR (6)	399.0	1	1282.4	1	5.0	-31	6.0	-89	1.3	1.8	6.8	39	0.90
KIMBALL INTERNATIONAL KBALB (6)	285.8	-11	893.3	-7	4.9	-55	-1.7	NM	1.7	3.4	2.4	46	0.27
LA-Z-BOY LZB (8)	459.0	-11	1605.8	3	2.8	-78	28.8	-55	0.6	2.5	8.4	18	0.97
LEGGETT & PLATT LEG	1056.8	-6	3145.3	-4	55.3	-20	152.2	-31	5.2	6.1	10.6	22	0.99
LINENS 'N THINGS LIN	468.9	14	1235.9	15	14.7	-20	21.5	-29	3.1	4.5	11.4	13	1.36
MAYTAG MYG	1227.1	16	3372.6	4	-24.5	NM	77.3	-63	NM	5.6	29.1	32	0.87
PIER 1 IMPORTS PIR (10)	357.2**	6	1113.1	9	13.8	-22	62.6	-9	3.9	5.2	16.0	13	0.89
RADIOSHACK RSH	1080.9	-5	3259.9	2	43.8	-43	131.5	-41	4.1	6.8	32.6	18	1.41
WHIRLPOOL WHR	2594.0	1	7695.0	-1	-94.0	NM	13.0	-96	NM	2.6	5.5	50	1.22
WILLIAMS-SONOMA WSM (11)	429.0	17	1519.7	17	1.4	-73	46.4	-21	0.3	1.4	11.0	32	0.85
(C) BEVERAGES													
GROUP COMPOSITE	24365.2	5	67569.1	4	2557.6	-5	7230.7	23	10.5	11.6	26.4	31	1.45
ANHEUSER-BUSCH ABV	3451.4	2	9813.3	4	558.6	9	1476.7	10	16.2	15.1	39.7	23	1.86
BROWN-FORMAN BF.B (6)	418.0	2	1357.7	2	39.2	-8	149.6	0	9.4	10.4	19.6	18	3.35
COCA-COLA KO	5397.0	0	15169.0	0	1074.0	1	3065.0	58	19.9	19.7	31.8	37	1.33
COCA-COLA BOTTLING CONSOLIDATED COKE	266.6	3	768.3	1	7.9	24	11.1	4	3.0	2.5	25.2	50	0.76
COCA-COLA ENTERPRISES CCE	4276.0	11	11732.0	5	26.0	-80	56.0	-75	0.6	3.4	2.4	NM	0.15
CONSTELLATION BRANDS STZ (10)	741.5	16	1927.7	10	35.9	38	78.2	31	4.8	4.1	13.5	15	2.80
COORS (ADOLPH) RKY	634.7	-3	1871.1	2	38.9	13	107.1	10	6.1	5.2	12.0	16	3.19
PEPSI BOTTLING GROUP PBG	2274.0	7	5981.0	7	150.0	22	292.0	30	6.6	5.8	17.1	24	1.99
PEPSICO PEP	6906.0	8	18949.0	8	627.0	-17	1995.0	8	9.1	11.8	26.7	31	1.55
(D) PERSONAL CARE													
GROUP COMPOSITE	19437.8	1	56553.9	0	2059.0	-3	4215.1	-18	10.6	11.0	31.8	35	1.47
AVON PRODUCTS AVP	1422.5	6	4243.0	5	100.3	9	320.0	11	7.1	6.9	NM	22	2.15
CHURCH & DWIGHT CHO	270.6	34	784.2	31	15.2	NM	40.9	79	5.6	NM	18.6	21	1.27
CLOROX CLX (6)	991.0**	3	3055.0	-2	79.0	-21	239.0	-28	8.0	10.4	16.0	30	1.27

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTH EARNINGS PER SHARE
	3QO	CHANGE	9	CHANGE	3QO	CHANGE	9	CHANGE	3QO	3QO			
	QUARTER 2001 \$ MIL.	FROM 2000 %	MONTHS 2001 \$ MIL.	FROM 2000 %	QUARTER 2001 \$ MIL.	FROM 2000 %	MONTHS 2001 \$ MIL.	FROM 2000 %	QUARTER 2001 %	QUARTER 2000 %			
COLGATE-PALMOLIVE CL	2391.2	1	7013.4	1	296.2	8	851.3	10	12.4	11.6	104.3	31	1.3
OIAL DL	430.5	12	1236.8	10	13.9	NM	44.5	20	3.2	NM	25.8	41	0.4
ECOLAB ECL	616.2	3	1792.9	6	57.3	-5	149.9	-1	9.3	10.0	24.0	22	1.5
ESTEE LAUDER EL (6)	1187.7	1	3326.5	3	97.1	3	182.6	-14	8.2	8.0	20.2	28	1.1
GILLETTE G	2362.0	2	6243.0	-3	296.0	-15	710.0	-22	12.5	15.2	27.7	54	0.5
PROCTER & GAMBLE PG (6)	9766.0	-2	28859.0	-2	1104.0	-4	1677.0	-31	11.3	11.6	25.6	37	2.0
(E) TOBACCO													
GROUP COMPOSITE	21418.2	13	64665.1	13	2608.6	1	7199.1	0	12.2	13.6	32.3	13	3.7
PHILIP MORRIS MO	18111.0	15	54962.0	15	2328.0	0	6402.0	-1	12.9	14.7	42.3	13	3.7
R.J. REYNOLDS TOBACCO HOLDINGS RJR	2273.0	9	6492.0	7	128.0	9	355.0	16	5.6	5.6	4.8	14	4.0
UNIVERSAL UVV (6)	616.4	-5	1988.1	-11	28.3	13	88.2	6	4.6	3.8	20.6	8	4.2
UST UST	417.8	7	1222.9	6	124.2	10	353.9	8	29.7	28.9	130.4	12	2.8
7 CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	14139.5	-2	41307.4	-1	435.1	622	1008.9	6	3.1	0.4	6.5	24	0.8
(A) GLASS, METAL & PLASTIC													
GROUP COMPOSITE	4936.5	-2	13899.9	-2	120.0	NM	237.6	NM	2.4	NM	0.9	NM	0.0
BALL BLL	1000.5	0	2843.1	0	36.3	-18	-107.3	NM	3.6	4.5	-19.2	NM	-3.3
CROWN CORK & SEAL CCK	1985.0	-2	5521.0	-2	-13.0	NM	-58.0	NM	NM	2.2	-15.9	NM	-2.3
OWENS-ILLINOIS OI	1360.2	-5	4056.1	-4	69.4	NM	365.9	NM	5.1	NM	23.5	3	2.5
SILGAN HOLDINGS SLGN	590.8	3	1479.7	4	27.3	48	37.0	23	4.6	3.2	386.1	9	2.3
(B) PAPER													
GROUP COMPOSITE	9203.0	-2	27407.5	0	315.1	-22	771.3	-31	3.4	4.3	8.1	21	1.0
BEMIS BMS	575.6	6	1734.5	9	36.1	12	101.2	4	6.3	5.9	15.7	17	2.5
GRAPHIC PACKAGING INTERNATIONAL GPK	270.8	-4	842.5	1	1.6	NM	9.0	NM	0.6	NM	0.0	NM	0.0
GREIF BROS. GBCOA (2)	435.8	79	1011.2	41	12.9	-31	74.4	33	3.0	7.7	15.7	6	4.2
MAIL-WELL MWL	411.8	-14	1263.0	-7	-1.7	NM	-12.4	NM	NM	2.0	-7.1	NM	-0.4
PACKAGING CORP. OF AMERICA PKG	455.2	-7	1376.8	-5	29.2	-27	88.5	-10	6.4	8.2	21.9	12	1.4
PACTIV PTV	717.0	-8	2157.0	-8	45.0	18	119.0	12	6.3	4.9	7.7	20	0.8
POTLATCH PCH	456.6	1	1357.1	-2	-6.6	NM	-47.7	NM	NM	NM	-8.6	NM	-2.2
ROCK-TENN RKT (3)	372.0	-1	1096.5	-2	9.3	52	25.7	NM	2.5	1.6	7.5	14	0.9
SEALED AIR SEE	766.2	-1	2286.1	1	44.4	-19	118.2	-28	5.8	7.1	20.7	28	1.4
SMURFIT-STONE CONTAINER SSCC	2088.0	-10	6386.0	-3	30.0	-62	66.0	-56	1.4	3.4	5.1	29	0.5
SONOCO PRODUCTS SON	649.3	-4	1929.7	-6	42.8	11	64.4	-50	6.6	5.7	12.5	23	1.0
TEMPLE-INLANO TIN	1057.0	-3	3172.0	-2	44.0	2	85.0	-47	4.2	4.0	6.5	21	2.4
WESTVACO W (2)	947.8	2	2795.0	6	28.0	-48	79.8	-54	3.0	5.8	6.8	16	1.5
8 DISCOUNT & FASHION RETAILING													
INDUSTRY COMPOSITE	175743.9	7	536336.6	8	4055.4	-5	13710.2	-17	2.3	2.6	11.4	36	0.91
ABERCROMBIE & FITCH ANF (11)	280.1	22	983.2	23	25.0	18	122.9	8	8.9	9.2	34.9	12	1.6
ALBERTO-CULVER ACV (3)	643.6	8	1900.6	10	31.8	13	86.8	14	4.9	4.7	15.0	23	1.9
AMAZON.COM AMZN	639.3	0	2007.3	12	-169.9	NM	-561.8	NM	NM	NM	NM	NM	-3.0
AMERICAN EAGLE OUTFITTERS AEOS (11)	292.4	40	967.7	44	15.3	451	80.0	52	5.2	1.3	25.7	19	1.5
AMES DEPARTMENT STORES AMESQ (11)	806.0**	-8	2930.3	-2	-276.4	NM	-449.4	NM	NM	NM	NM	NM	-16.5
ANN TAYLOR STORES ANN (11)	310.3**	1	961.0	9	6.4	-52	21.1	-48	2.1	4.4	7.5	15	1.5
AUTOZONE AZO (4)	1640.7	10	3754.6	8	26.5	-75	121.7	-42	1.6	7.0	20.3	38	1.5
BARNES & NOBLE BKS (11)	1050.0	14	3665.0	17	-1.7	NM	-47.2	NM	NM	NM	-6.5	NM	-0.8
BIG LOTS BLJ (11)	748.4	6	2633.9	9	-10.7	NM	57.8	-34	NM	1.3	6.9	13	0.5
BJ'S WHOLESALE CLUB BJ (11)	1305.7	9	3973.8	13	36.5	17	114.3	18	2.8	2.6	19.2	27	1.9
BORDERS GROUP BGP (11)	739.8	6	2661.8	9	0.1	NM	56.9	-43	0.0	0.0	6.4	22	0.6
BUILDING MATERIALS HOLDING BMHC	326.2	21	817.8	5	7.3	7	16.5	-10	2.2	2.5	7.8	8	1.3
BURLINGTON COAT FACTORY BCF (7)	451.6	9	1700.9	4	-20.6	NM	17.3	-39	NM	NM	10.2	10	1.4
COW COMPUTER CENTERS COWC	991.1	-4	2973.4	5	43.2	-4	126.7	5	4.4	4.4	23.3	24	1.8
CHARMING SHOPPES CHRS (11)	402.7	-6	1232.1	6	14.9	-45	32.4	-26	3.7	6.2	7.7	13	0.3
COLE NATIONAL CNJ (11)	273.3	3	842.4	7	1.5	223	5.8	NM	0.5	0.2	3.5	40	0.3
COSTCO WHOLESALE COST (4)	11134.6**	5	27159.8	8	190.7	-5	472.6	-6	1.7	1.9	12.9	31	1.2
CSK AUTO CAO (11)	381.7	2	1089.9	3	-23.8	NM	-26.7	NM	NM	NM	-17.6	NM	-0.7
OILLARO'S DDS (11)	1885.6**	-1	6585.8	-2	-20.6	NM	64.4	-22	NM	0.1	1.7	25	0.5
DOLLAR TREE STORES DLTR	444.7	18	1272.4	17	14.6	-33	47.0	-18	3.3	5.8	19.7	23	0.9
FAMILY DOLLAR STORES FDO (4)	920.8	17	2845.2	18	34.1	12	148.0	9	3.7	3.8	19.8	27	1.1
FEDERATED DEPARTMENT STORES FDO (11)	3732.0**	-8	13669.0	-3	110.0	75	500.0	-17	2.9	1.6	-2.9	NM	-0.7
FOOTSTAR FTS	656.4	11	1822.5	12	-44.5	NM	-32.6	NM	NM	4.2	-5.0	NM	-0.7
GAP GPS (11)	3245.2	10	11004.0	15	89.8	-51	477.0	43	2.8	6.2	20.4	18	0.7
GOODY'S FAMILY CLOTHING GDYS (11)	286.9	-3	950.4	-1	-11.1	NM	-1.7	NM	NM	NM	-0.1	NM	0.0
HOME DEPOT HO (11)	14576.0	16	37239.0	13	924.0	10	2021.0	1	6.3	6.6	16.0	34	1.1
INSIGHT ENTERPRISES NSIT	490.2	-9	1552.5	4	8.3	-49	33.6	20	1.7	3.0	15.3	15	1.1
INTIMATE BRANOS IB (11)	1150.9	-3	4116.4	1	68.9	-31	325.6	27	6.0	8.4	51.8	15	0.7
JO-ANN STORES JAS.A (11)	330.2	10	1155.5	7	-16.1	NM	-31.6	NM	NM	NM	-12.7	NM	-1.5
KMART KM (11)	8917.0	-1	28891.0	2	-95.0	NM	129.0	NM	NM	NM	1.0	41	0.1
KOHL'S KSS (11)	1515.8	21	5227.1	28	86.5	35	340.1	43	5.7	5.1	17.1	47	1.2

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES			PROFITS				MARGINS			RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 11-1	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001	3RD QUARTER 2000			
LANOS' ENO LE ⁽¹¹⁾	285.8	4	1135.5	9	3.0	NM	40.7	52	1.1	NM	13.9	22	1.49
LIMITEO LTO ⁽¹¹⁾	2192.1	-4	7840.9	2	71.6	-8	340.4	-26	3.3	3.4	16.3	13	0.88
LOWE'S LOW ⁽¹¹⁾	6126.7	16	15946.1	18	329.1	18	695.2	13	5.4	5.3	14.6	30	1.16
MAY DEPARTMENT STORES MAY ⁽¹¹⁾	3173.0**	1	11301.0	5	111.0	-18	738.0	-4	3.5	4.3	20.4	13	2.55
MEN'S WEARHOUSE MW ⁽¹¹⁾	297.2	1	1048.7	7	10.3	-36	61.3	2	3.4	5.4	16.0	11	1.86
MICHAELS STORES MIKE ⁽¹¹⁾	486.1	12	1826.3	16	4.7	3	62.1	1	1.0	1.0	10.6	23	2.28
NEIMAN MARCUS GROUP NMGA ⁽⁵⁾	635.8**	-1	2258.3	1	-20.6	NM	57.5	-40	NM	1.6	11.4	12	2.26
NOROSTROM JWN ⁽¹¹⁾	1581.1**	6	4521.5	6	38.7	-15	90.5	-37	2.4	3.0	6.9	22	0.65
OFFICE DEPOT ODP	2782.5	-1	8353.9	-2	62.5	23	160.8	-26	2.2	1.8	-0.4	NM	-0.04
OFFICEMAX OMX ⁽¹¹⁾	978.8	-9	3595.9	-6	-24.0	NM	-125.5	NM	NM	NM	-16.0	NM	-1.33
O'REILLY AUTOMOTIVE ORLY	294.0	17	813.7	21	20.1	22	50.4	19	6.9	6.6	11.2	25	1.14
PAYLESS SHOESOURCE PSS ⁽¹¹⁾	806.0	-1	2274.3	7	36.4	-25	80.0	-14	4.5	6.0	23.2	11	5.02
PC CONNECTION PCCC	308.7	-24	907.8	-18	1.9	-81	5.8	-78	0.6	2.5	7.8	26	0.45
PENNEY (J.C.) JCP ⁽¹¹⁾	7211.0	0	24306.0	0	-53.0	NM	-335.0	NM	NM	NM	-7.7	NM	-1.66
PEP BOYS-MANNY, MOE & JACK PBY ⁽¹¹⁾	572.9	-10	1671.6	-7	12.3	260	22.7	NM	2.1	0.5	-6.5	NM	-0.77
PETSMART PETM ⁽¹¹⁾	582.4	8	1775.0	8	2.5	NM	-23.9	NM	0.4	NM	-9.5	NM	-0.24
ROSS STORES ROST ⁽¹¹⁾	724.6	10	2178.1	10	35.4	-2	115.3	-3	4.9	5.5	28.9	18	1.79
SAKS SKS ⁽¹¹⁾	1270.7**	-9	4858.5	-1	-62.2	NM	9.0	-94	NM	NM	0.0	NM	0.00
SCHOOL SPECIALTY SCHS ⁽⁸⁾	260.2	20	495.2	15	16.5	45	4.4	-31	6.4	5.2	6.7	33	0.94
SEARS, ROEBUCK S	9753.0	2	28836.0	1	262.0	-6	241.0	-73	2.7	2.9	11.1	20	2.04
SHERWIN-WILLIAMS SHW	1366.8	-3	3932.7	-3	90.3	-15	217.7	-17	6.6	7.6	-2.1	NM	-0.13
SHOPKO STORES SKO ⁽¹¹⁾	794.5	-3	2716.9	4	2.6	-50	-48.7	NM	0.3	0.6	-8.7	NM	-1.97
SPIEGEL SPGLA	703.8	-13	2279.0	-7	-12.3	NM	-19.5	NM	NM	1.7	5.8	16	0.35
SPORTS AUTHORITY TSA ⁽¹¹⁾	371.6	-4	1132.8	-3	7.3	8	14.1	NM	2.0	1.7	6.6	20	0.28
STAPLES SPLS ⁽¹¹⁾	2314.2	5	8096.1	10	40.4	-5	-31.8	NM	1.7	1.9	2.9	NM	0.11
STEIN MART SMRT	280.3	5	872.0	8	-8.0	NM	1.5	-91	NM	0.8	12.6	15	0.56
TALBOTS TLB ⁽¹¹⁾	384.3**	6	1258.5	14	17.8	22	91.0	45	4.6	4.0	22.7	15	1.95
TARGET TGT ⁽¹¹⁾	8952.0**	8	29621.0	10	272.0	6	1077.0	6	3.0	3.1	18.5	23	1.43
TIFFANY TIF ⁽¹¹⁾	371.3**	-1	1284.1	0	36.1	-8	151.5	-2	9.7	10.5	19.2	19	1.24
TJX TJX ⁽¹¹⁾	2487.6	10	7509.8	9	111.9	-2	370.8	-3	4.5	5.1	43.8	18	1.88
TOYS 'R' US TOY ⁽¹¹⁾	2021.0	1	8881.0	-5	-29.0	NM	204.0	-55	NM	0.2	4.1	29	0.67
VALUE CITY DEPARTMENT STORES VCO ⁽¹¹⁾	540.7	2	1742.6	15	-5.8	NM	-36.5	NM	NM	0.0	-48.9	NM	-3.42
VENATOR GROUP Z ⁽¹¹⁾	1048.0	8	3376.0	6	4.0	-69	78.0	-37	0.4	1.3	11.5	19	0.77
WAL-MART STORES WMT ⁽¹¹⁾	52799.0	15	157407.0	12	1622.0	2	5005.0	3	3.1	3.5	19.3	37	1.42
ZALE ZLC ⁽⁵⁾	417.0	10	1696.4	14	3.0	-74	78.0	-26	0.7	3.1	9.8	12	2.36
ELECTRICAL & ELECTRONICS													
INDUSTRY COMPOSITE	43694.1	-25	143538.2	-11	-8944.1	NM	-64289.3	NM	NM	8.8	-41.4	NM	-2.59
(A) ELECTRICAL PRODUCTS													
GROUP COMPOSITE	4135.9	9	11712.4	5	175.5	-40	538.1	-34	4.2	7.7	11.2	17	1.62
AMERICAN POWER CONVERSION APCC	360.9	-9	1085.2	1	22.3	-50	84.3	-34	6.2	11.3	10.3	21	0.63
AMETEK AME	256.5	1	782.0	2	17.7	2	54.7	7	6.9	6.8	22.3	13	2.17
COOPER INDUSTRIES CBE	1051.8	-8	3219.9	-4	74.3	-19	198.7	-26	7.1	8.0	14.6	13	3.05
HUBBELL HUB.B	325.7	-10	1011.0	-6	19.5	-41	62.4	-43	6.0	9.1	11.8	18	1.54
NATIONAL SERVICE INDUSTRIES NSI ⁽⁴⁾	655.1	-7	1911.5	-2	-17.9	NM	10.5	-86	NM	4.9	4.2	28	0.65
SMITH (A.O.) AOS	269.1	-7	895.6	-8	0.4	-95	19.6	-50	0.1	2.5	4.8	17	0.93
SPX SPW	1216.7	89	2807.2	43	59.2	-6	108.0	-28	4.9	9.7	9.7	22	4.57
(B) ELECTRONICS													
GROUP COMPOSITE	12294.1	-15	37531.2	-11	-1892.4	NM	-3380.7	NM	NM	NM	-12.3	NM	-0.85
ANDEW ANOW ⁽³⁾	281.2	-2	769.0	-4	20.3	-18	40.7	-35	7.2	8.6	10.3	25	0.76
AVAYA AV ⁽³⁾	1442.0	-29	5008.0	-15	-328.0	NM	-368.0	NM	NM	NM	-78.8	NM	-1.39
HARRIS HRS ⁽⁶⁾	443.4	-4	1451.2	2	17.1	NM	57.3	NM	3.9	NM	6.7	31	1.09
HUGHES ELECTRONICS GMH	2103.3	25	5981.4	14	-227.2	NM	-481.6	NM	NM	NM	-6.6	NM	-0.48
L-3 COMMUNICATIONS HOLDINGS LLL	618.2	20	1641.6	21	33.4	39	70.9	38	5.4	4.7	9.0	33	2.73
MOTOROLA MOT	7406.0	-22	22680.0	-18	-1408.0	NM	-2700.0	NM	NM	5.6	-18.0	NM	-1.17
(C) INSTRUMENTS													
GROUP COMPOSITE	5183.5	-10	17538.4	8	-63.7	NM	845.2	-14	NM	4.8	10.5	31	0.92
ACTERNA ACTR ⁽⁹⁾	314.8	-10	1001.7	35	-136.4	NM	-164.4	NM	NM	NM	NM	NM	-0.96
AGILENT TECHNOLOGIES A ⁽²⁾	1806.0	-23	6736.0	6	-214.0	NM	50.0	-87	NM	6.1	6.5	30	0.76
APPLIED BIOSYSTEMS GROUP ABI ⁽⁶⁾	366.6	1	1211.5	8	32.2	-34	137.5	-15	8.8	13.5	18.8	33	0.89
BECKMAN COULTER BEC	476.6	4	1405.7	3	33.0	13	93.2	13	6.9	6.4	29.5	19	2.15
DANAHER DHR	901.6	-9	2863.5	4	87.7	5	264.6	12	9.7	8.5	16.0	24	2.38
KLA-TENCOR KLAC ⁽⁶⁾	502.8	31	1722.6	35	86.5	199	352.8	82	17.2	7.6	24.0	20	2.22
PERKINELMER PKI	302.1	-11	968.8	1	21.6	NM	54.6	83	7.2	NM	13.9	30	0.90
THERMO ELECTRON TMO	512.9	-6	1628.5	-4	25.7	253	56.9	31	5.0	1.3	3.1	52	0.42
(D) SEMICONDUCTORS & OTHER COMPONENTS													
GROUP COMPOSITE	22080.6	-35	76756.2	-16	-7163.4	NM	-62291.8	NM	NM	13.6	-61.1	NM	-3.50
ADVANCED MICRO DEVICES AMO	765.9	-37	2939.9	-15	-186.9	NM	-44.7	NM	NM	35.8	3.7	29	0.39
AGERE SYSTEMS AGR.A ⁽³⁾	600.0	-60	2718.0	-27	-3354.0	NM	-4608.0	NM	NM	8.7	NM	NM	-3.46

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTH EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
AMKOR TECHNOLOGY AMKR	334.7	-48	1165.5	-33	-128.7	NM	-314.2	NM	NM	7.0	-23.9	NM	1.7
ANALOG DEVICES ADI ⁽²⁾	479.9	-32	1853.6	5	39.3	-80	332.2	-18	8.2	27.4	19.7	29	1.3
ATMEL ATML	294.8	-44	1187.7	-17	-442.8	NM	-386.8	NM	NM	14.4	-19.6	NM	-0.6
AVX AVX ⁽⁹⁾	305.5	-56	1271.5	-29	-28.1	NM	126.2	-64	NM	22.5	19.1	11	1.6
BENCHMARK ELECTRONICS BHE	258.0	-44	1007.3	-17	-57.0	NM	-54.0	NM	NM	1.4	-13.2	NM	-2.3
FAIRCHILD SEMICONDUCTOR INTL. FCS	325.4	-32	1083.1	-18	-19.1	NM	-25.5	NM	NM	14.6	8.3	34	0.6
INTEL INTC	6545.0	-25	19556.0	-22	106.0	-96	787.0	-91	1.6	28.7	8.3	59	0.4
JABIL CIRCUIT JBL ⁽⁴⁾	944.1	-11	3201.7	12	11.2	-76	70.8	-41	1.2	4.4	8.4	38	0.5
JOS UNIPHASE JDSU ⁽⁶⁾	328.6	-58	1849.8	8	-1224.4	NM	-5543.4	NM	NM	NM	NM	NM	-47.8
LSI LOGIC LSI	396.7	-45	1379.1	-31	-398.1	NM	-741.8	NM	NM	2.5	-25.3	NM	-1.9
MICRON TECHNOLOGY MU ⁽⁴⁾	480.3	-79	2364.3	-53	-575.5	NM	-880.7	NM	NM	31.9	-7.3	NM	-0.8
MOLEX MOLX ⁽⁶⁾	430.5	-31	1540.8	-15	25.2	-61	96.8	-48	5.9	10.3	9.0	35	0.8
NATIONAL SEMICONDUCTOR NSM ⁽⁷⁾	339.3	-47	1216.1	-32	-54.6	NM	-59.8	NM	NM	22.5	2.7	NM	0.2
NVIDIA NVDA ⁽¹¹⁾	260.3	53	719.4	61	33.6	49	90.5	63	12.9	13.2	22.5	65	0.7
ON SEMICONDUCTOR ONNN	276.5	-49	947.7	-40	-68.9	NM	-264.1	NM	NM	5.5	NM	NM	-1.5
PLEXUS PLXS ⁽³⁾	256.8	3	790.2	31	6.9	-43	25.9	-19	2.7	4.9	9.2	29	0.9
SANMINA SANM ⁽³⁾	600.7	-56	2568.5	-24	-167.8	NM	-75.5	NM	NM	7.5	2.2	NM	0.1
SCI SYSTEMS SCI ⁽⁶⁾	1772.7	-13	5863.3	-11	-61.8	NM	-68.4	NM	NM	2.5	-0.9	NM	-0.1
SOLECTRON SLR ⁽⁴⁾	3594.9	-24	12996.8	15	-250.3	NM	-314.1	NM	NM	3.6	-2.4	NM	-0.1
TEXAS INSTRUMENTS TXN	1849.0	-41	6414.0	-27	-117.0	NM	-85.0	NM	NM	21.5	5.0	92	0.3
THOMAS & BETTS TNB	373.2	-16	1155.6	-13	-45.6	NM	-55.9	NM	NM	NM	-15.6	NM	-2.1
VIASYSTEMS GROUP VG	268.1	-34	966.4	-8	-205.0	NM	-408.3	NM	NM	2.3	NM	NM	-2.8
10 FOOD													
INDUSTRY COMPOSITE	102899.4	9	311853.7	8	2811.4	-5	8944.7	5	2.7	3.1	16.7	23	1.2
(A) FOOD DISTRIBUTION													
GROUP COMPOSITE	18435.4	6	56525.6	5	270.6	46	598.0	6	1.5	1.1	13.4	29	0.8
FLEMING FLM	4022.1	26	11640.6	8	19.1	NM	21.1	NM	0.5	NM	-3.2	NM	-0.4
INTERNATIONAL MULTIFOODS IMC ⁽¹⁰⁾	684.9	17	2030.5	13	2.8	-47	7.5	-56	0.4	0.9	6.1	26	0.8
NASH FINCH NAFC	1274.8**	6	3129.3	5	6.0	51	14.6	37	0.5	0.3	9.9	15	1.6
PERFORMANCE FOOD GROUP PFGC	798.8	15	2317.1	20	12.9	55	30.1	59	1.6	1.2	8.4	29	1.0
SPARTAN STORES SPTN ⁽⁹⁾	841.1*	8	2539.2	16	9.5	5	18.4	47	1.1	1.2	11.0	11	1.2
SUPERVALU SVU ⁽¹⁰⁾	4715.3	-12	17133.7	-4	52.1	-9	18.8	-91	1.1	1.1	3.5	44	0.5
SYSCO SYY ⁽⁶⁾	5828.7	9	16962.5	10	164.0	14	477.5	22	2.8	2.7	28.7	26	0.9
UNITED NATURAL FOODS UNFI ⁽⁵⁾	269.7	17	772.7	12	4.2	65	10.1	NM	1.6	1.1	9.8	29	0.7
(B) FOOD PROCESSING													
GROUP COMPOSITE	44490.5	14	130483.2	12	2125.2	2	6378.7	4	4.8	5.3	18.2	23	1.3
ARCHER DANIELS MIDLAND ADM ⁽⁶⁾	5504.1	19	15979.8	14	131.6	20	280.9	3	2.4	2.4	6.4	24	0.6
CAMPBELL SOUP CPB ⁽⁵⁾	1330.0	8	4834.0	4	52.0	-12	445.0	-7	3.9	4.8	NM	19	1.5
CHIKITA BRANDS INTERNATIONAL CQB	508.7	9	1681.4	-3	-38.2	NM	-45.1	NM	NM	NM	-36.9	NM	-2.1
CONAGRA FOODS CAG ⁽⁷⁾	7607.8	8	20443.4	7	190.4	16	427.6	75	2.5	2.3	17.6	17	1.3
CORN PRODUCTS INTERNATIONAL CPO	474.5	-1	1411.3	1	19.5	55	47.4	34	4.1	2.6	6.5	18	1.6
DEAN FOODS DF ⁽⁷⁾	1143.9	9	3408.2	11	13.1	-50	31.5	-59	1.1	2.5	8.6	27	1.7
DEL MONTE FOODS DLM ⁽⁶⁾	272.3	4	1045.3	12	-0.8	NM	24.3	-78	NM	2.4	135.5	13	0.6
OREYER'S GRANO ICE CREAM DRYR	419.9	22	1076.8	18	6.0	-45	8.7	-67	1.4	3.2	3.4	NM	0.1
FLOWERS FOODS FLO	385.6	4	1221.8	4	8.5	NM	-13.5	NM	2.2	NM	4.1	NM	-1.2
GENERAL MILLS GIS ⁽⁷⁾	1771.2	6	5278.8	6	191.1	20	494.6	17	10.8	9.5	NM	20	2.3
HEINZ (H.J.) HNZ ⁽⁶⁾	2185.5	1	7147.9	1	200.5	-2	300.5	-36	9.2	9.4	35.7	31	1.4
HERSHEY FOODS HSY	1304.2	9	3283.3	9	120.8	12	252.1	15	9.3	9.0	29.6	24	2.6
HORMEL FOODS HRL ⁽²⁾	1039.5	17	3005.4	13	33.2	14	113.6	4	3.2	3.3	18.4	19	1.2
INTERSTATE BAKERIES IBC ⁽⁷⁾	828.7	1	2687.7	-1	9.8	-64	32.7	41	1.2	3.3	11.1	26	0.9
KELLOGG K	2590.1	40	6640.3	23	150.3	-17	357.4	-28	5.8	9.9	51.7	28	1.1
KRAFT FOODS KFT	8056.0	30	25115.0	28	503.0	-8	1334.0	16	6.2	8.8	7.5	30	1.1
MCCORMICK MKC ⁽¹⁾	570.7	15	1671.4	16	34.3	10	87.5	10	6.0	6.3	34.1	21	2.0
PILGRIM'S PRIDE CHX ⁽³⁾	641.3	69	1828.7	60	13.8	22	29.3	-22	2.2	3.0	11.0	12	1.0
RALCORP RAH ⁽³⁾	313.9	16	900.7	40	9.1	72	31.2	8	2.9	2.0	10.5	15	1.3
RALSTON PURINA RAL ⁽³⁾	790.7	12	2302.0	7	86.8	4	218.7	27	11.0	11.8	44.2	32	1.0
SARA LEE SLE ⁽⁶⁾	4518.0	1	13053.0	0	242.0	2	1456.0	87	5.4	5.3	126.9	12	1.9
SMITHFIELD FOODS SFD ⁽⁸⁾	1636.4	15	4684.1	12	56.9	28	191.3	111	3.5	3.1	21.6	10	2.1
WRIGLEY (WM.) JR. WWY	597.6	12	1783.1	11	91.5	9	273.1	9	15.3	15.7	29.2	33	1.5
(C) FOOD RETAILING													
GROUP COMPOSITE	39973.5	4	124844.9	5	415.5	-41	1968.1	8	1.0	1.8	14.2	22	1.2
ALBERTSON'S ABS ⁽¹¹⁾	9577.0	4	28452.0	1	-151.0	NM	255.0	60	NM	2.1	7.6	32	1.0
GREAT ATLANTIC & PACIFIC TEA GAP ⁽¹⁰⁾	2547.6	4	8490.6	5	3.2	NM	-21.1	NM	NM	NM	-4.5	NM	0.9
KROGER KR ⁽¹¹⁾	11485.0	4	39279.0	7	256.0	22	927.0	71	2.2	1.9	34.7	18	1.3
PATHMARK STORES PTMK ⁽¹¹⁾	997.7	7	3030.9	8	-61.2	NM	-171.0	NM	NM	NM	41.4	NA	NA
PENN TRAFFIC PNFT ⁽¹¹⁾	644.3**	2	1944.4	5	-22.0	NM	-70.4	NM	NM	NM	46.6	NM	4.9

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
RUDOLPH ROK ⁽³⁾	627.6	-7	2028.3	0	12.2	2	-11.9	NM	1.9	1.8	-0.2	NM	-0.02
SAFEWAY SWY	7962.3	7	23614.6	8	309.2	15	900.3	14	3.9	3.6	19.2	18	2.33
7-ELEVEN SE	2679.1**	6	7564.6	6	41.4	1	76.5	-19	1.5	1.6	66.0	13	0.79
WEIS MARKETS WMK	498.8	3	1480.3	-2	11.7	-39	37.6	-36	2.3	3.9	10.2	20	1.46
WINN-DIXIE STORES WIN ⁽⁶⁾	2954.0	0	8960.2	-3	22.4	138	46.1	NM	0.8	0.3	7.7	27	0.42

FUEL													
INDUSTRY COMPOSITE	145462.0	-7	460295.6	6	7845.4	-30	34779.0	18	5.4	7.2	20.8	12	3.18

(A) COAL, OIL & GAS GROUP COMPOSITE	129295.7	-10	414190.9	3	6706.2	-36	31917.2	14	5.2	7.3	23.6	11	3.65
AMERGAO HESS AHC	2888.0	2	10531.0	27	167.0	-35	860.0	26	5.8	9.1	24.9	4	13.44
ANADARKO PETROLEUM APC	1743.0	-4	6990.0	122	-268.0	NM	798.0	117	NM	13.7	16.2	12	4.75
APACHE APA	659.0	6	2256.6	45	156.8	-22	685.4	48	23.8	32.4	22.9	7	7.15
ARCH COAL ACI	349.2	-2	1088.9	4	-8.1	NM	-1.2	NM	NM	NM	1.5	94	0.23
ASHLAND ASH ⁽³⁾	2151.0	-1	5901.0	-4	125.0	29	406.0	39	5.8	4.5	18.2	7	5.77
BURLINGTON RESOURCES BR	655.0	-14	2715.0	26	73.0	-64	637.0	72	11.1	26.3	25.5	8	4.45
CHEVRON CVX	10489.0	-12	33104.0	-4	1168.0	-24	4092.0	11	11.1	12.8	24.3	10	8.68
CONOCO COC	9744.0**	-9	30764.0	6	281.0	-43	1449.0	7	2.9	4.6	30.9	8	3.14
CONSOL ENERGY CNX ⁽⁶⁾	541.6**	0	1878.9	18	-11.5	NM	138.6	117	NM	0.8	52.8	13	2.13
DEVON ENERGY DVN	586.7**	-19	2335.5	21	84.7	-49	571.9	35	14.4	22.7	22.5	6	6.51
EOG RESOURCES EOG	353.7	-11	1417.4	45	72.0	-38	423.4	80	20.3	29.3	37.2	7	4.84
EXXON MOBIL XOM	53009.0**	-9	166493.0	-1	3180.0	-29	12640.0	1	6.0	7.7	23.7	16	2.52
HOLLY HOC ⁽⁵⁾	264.8	-9	816.2	7	19.6	296	53.0	545	7.4	1.7	36.4	4	4.77
KERR-MCGEE KMG	883.5	-20	2880.5	-4	26.3	-90	556.3	-1	3.0	23.9	25.7	7	8.14
MASSEY ENERGY MEE ⁽²⁾	311.5**	6	909.7	8	-9.4	NM	-8.7	NM	NM	11.0	-0.8	NM	-0.10
MITCHELL ENERGY & DEVELOPMENT MND	356.3	-20	1497.5	34	10.5	-86	211.4	31	2.9	16.7	37.2	9	6.03
MURPHY OIL MUR	1139.3	-9	3629.1	8	41.7	-54	302.1	42	3.7	7.2	26.5	9	8.69
OCCIDENTAL PETROLEUM OXY	3285.0	-15	11605.0	20	444.0	11	1428.0	16	13.5	10.4	31.5	5	4.72
PEABODY ENERGY BTU ⁽⁹⁾	682.3**	13	2004.0	12	4.1	NM	11.1	NM	0.6	NM	12.8	NA	NA
PENNZOIL-QUAKER STATE PZL	596.1	-4	1769.1	-4	4.6	-38	10.6	-59	0.8	1.2	-1.2	NM	-0.13
PHILLIPS PETROLEUM P	5534.0	8	15251.0	1	374.0	-12	1481.0	32	6.8	8.3	31.4	7	8.48
SUNOCO SUN	2989.0	-9	9461.0	3	92.0	NM	394.0	53	3.1	NM	30.4	6	6.53
TESORO PETROLEUM TSO	1412.0**	1	3938.9	7	32.8	31	84.0	72	2.3	1.8	17.8	5	2.58
TEXACO TX	10713.0	-20	37755.0	3	101.0	-87	1718.0	-14	0.9	6.0	15.7	NA	4.15
ULTRAMAR DIAMOND SHAMROCK UOS	4019.9	-11	13339.6	9	149.0	17	552.1	70	3.7	2.8	41.6	6	8.68
UNOCAL UCL	1579.0	-33	5489.0	-14	102.0	-42	629.0	14	6.5	7.5	25.4	10	3.23
USX-MARATHON GROUP MRO	8502.0**	-7	26243.0	3	193.0	60	1283.0	73	2.3	1.3	16.7	9	3.17
VALERO ENERGY VLO	3858.7	-9	12127.1	15	101.1	-21	512.0	108	2.6	3.0	31.0	4	9.44

(B) PETROLEUM SERVICES GROUP COMPOSITE	16166.3	29	46104.7	29	1139.2	54	2861.8	81	7.0	5.9	7.9	28	1.14
BAKER HUGHES BHI	1436.0	6	4006.5	4	137.1	110	312.7	118	9.5	4.8	8.6	45	0.81
COOPER CAMERON CAM	417.2**	19	1156.7	11	34.4	314	68.5	84	8.2	2.4	6.6	39	1.03
FMC TECHNOLOGIES FTI	474.0	5	1381.5	-1	11.4	-32	18.0	-60	2.4	3.7	11.4	NA	NA
GLOBAL MARINE GLM	313.8	15	965.0	36	62.1	92	187.1	156	19.8	11.9	15.5	13	1.26
HALLIBURTON HAL	3391.0**	12	9874.0	13	181.0	39	410.0	96	5.3	4.3	8.7	27	0.90
NABORS INDUSTRIES NBR	593.7	72	1692.3	85	108.2	181	295.4	267	18.2	11.2	19.7	14	2.17
NATIONAL-OILWELL NOI	486.8	70	1281.7	56	28.9	143	75.7	993	5.9	4.2	10.1	18	1.01
NOBLE AFFILIATES NBL	303.0	-15	1276.9	38	3.8	-93	161.1	33	1.3	16.0	22.5	9	4.06
NOBLE DRILLING NE	272.8	21	741.8	16	78.0	74	200.4	76	28.6	19.8	15.1	16	1.87
PATTERSON-UTI ENERGY PTEN	289.1	94	815.3	112	60.4	487	145.5	808	20.9	6.9	26.5	9	2.16
PRIORE INTERNATIONAL POE	406.3	34	1150.4	42	4.9	-71	87.5	327	1.2	5.5	2.6	17	0.75
SCHLUMBERGER SLB	3624.4	48	10168.4	47	194.6	-5	337.3	-32	5.4	8.4	7.0	49	1.00
SMITH INTERNATIONAL SH	909.7	27	2647.4	32	42.1	105	114.0	144	4.6	2.9	15.7	17	2.79
TRANSMONTAIGNE TMC ⁽⁸⁾	1542.3	27	4261.0	12	9.6	NM	19.0	315	0.6	0.0	6.5	17	0.36
TRANSOCEAN SEDCO FOREX RIG	770.2	145	2072.5	127	97.6	104	213.9	84	12.7	15.2	1.9	48	0.63
VARCO INTERNATIONAL VRC	327.5	55	905.6	46	24.9	130	55.8	698	7.6	5.1	8.7	21	0.73
WEATHERFORD INTERNATIONAL WFT	608.6	32	1707.8	33	60.2	180	160.1	258	9.9	4.7	4.7	63	0.55

HEALTH CARE													
INDUSTRY COMPOSITE	139034.6	13	412140.4	13	13003.2	15	37032.0	19	9.4	9.1	22.2	36	1.32

(A) DRUG DISTRIBUTION GROUP COMPOSITE	43351.9	14	130759.2	17	584.5	109	1489.8	218	1.3	0.7	9.1	52	0.59
CAROLINA HEALTH CAH ⁽⁶⁾	11773.4	7	36754.5	18	246.4	30	692.6	17	2.1	1.7	16.1	33	1.99
CAREMARK RX CMX	1380.5	27	4127.8	28	49.1	82	130.0	88	3.6	2.5	NM	22	0.64
CVS CVS	5410.8	10	16290.9	12	123.7	-22	543.5	1	2.3	3.2	16.6	13	1.83
O&K HEALTHCARE RESOURCES OKWO ⁽⁶⁾	529.1	51	1468.9	28	3.6	133	9.4	48	0.7	0.4	7.8	24	2.16
OUANE REAOE ORO	279.4	15	843.5	18	6.4	2	16.2	24	2.3	2.6	9.3	24	1.28
HERBALIFE INTERNATIONAL HERBA	261.6	-4	762.4	-8	14.0	19	32.6	11	5.4	4.3	15.8	9	1.32
LONGS DRUG STORES LOG ⁽¹¹⁾	1041.9	5	3180.5	6	11.2	-35	30.9	-42	1.1	1.7	5.5	22	1.04
McKESSON MCK ⁽⁹⁾	12159.3	23	35222.3	22	79.0	28	8.9	-76	0.7	0.6	0.4	NM	0.04

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTH EARNINGS PER SHARE
	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 %	3QO QUARTER 2000 %			
OMNICARE OCR	541.2	10	1594.9	9	13.6	0	51.0	32	2.5	2.8	5.4	30	0.69
RITE AIO RAD ⁽¹⁰⁾	3691.1	7	11504.7	11	-179.3	NM	-752.5	NM	NM	NM	NM	NM	-2.7
WALGREEN WAG ⁽⁴⁾	6283.6	17	19008.8	16	216.9	0	727.2	12	3.5	4.0	17.7	37	0.8
(B) DRUGS & RESEARCH													
GROUP COMPOSITE	46287.8	11	136619.8	12	8610.3	10	24976.0	13	18.6	18.7	28.4	36	1.40
ABBOTT LABORATORIES ABT [†]	4181.2	26	11840.2	18	631.4	-4	936.8	-54	15.1	19.7	19.7	50	1.0
ALLERGAN AGN	427.0	8	1281.8	6	66.8	22	142.6	-5	15.6	13.8	22.3	46	1.5
AMERICAN HOME PRODUCTS AHP	3736.3	7	10401.8	7	252.1	-67	1462.6	-50	6.7	21.8	-75.6	NM	-1.8
AMGEN AMGN	1003.1	6	2891.4	8	329.9	-8	956.7	3	32.9	37.8	22.9	54	1.0
BARR LABORATORIES BRL ⁽⁶⁾	315.3	206	593.6	76	67.1	545	102.6	235	21.3	10.1	26.9	22	3.1
BIOMERGEN BGEN	265.2	13	762.9	12	69.8	2	213.8	-18	26.3	29.3	22.1	30	1.8
BRISTOL-MYERS SQUIBB BMY	4743.0	4	14141.0	5	1231.0	38	3576.0	18	26.0	19.6	48.7	23	2.3
CHIRON CHIR [†]	280.7	42	763.6	24	51.4	19	130.1	-7	18.3	21.8	0.3	NM	-0.0
FOREST LABORATORIES FRX ⁽⁹⁾	376.3**	34	1051.0	32	80.0	55	223.2	107	21.3	18.4	22.2	47	1.5
GENENTECH DNA	523.7**	24	1512.3	28	42.7	642	113.8	NM	8.2	1.4	2.2	NM	0.2
IVAX IVX	322.0	76	883.7	60	54.3	76	182.3	102	16.9	16.9	32.1	18	1.1
LILLY (ELI) LLY	2874.4	2	8713.6	11	586.7	-25	2221.2	-3	20.4	27.7	44.2	28	2.7
MERCK MRK	11919.6	13	35157.8	22	1948.2	6	5420.9	7	16.3	17.4	48.7	21	3.0
MYLAN LABORATORIES MYL ⁽⁹⁾	286.3	38	772.9	31	64.1	91	156.8	NM	22.4	16.1	15.6	24	1.5
PFIZER PFE	7898.0	10	23229.0	9	2072.0	52	5795.0	151	26.2	19.0	40.4	37	1.1
PHARMACIA PHA	4466.0	4	14406.0	6	428.0	54	1434.0	83	9.6	6.5	13.4	34	1.2
SCHERING-PLOUGH SGP	2382.0	0	7330.0	-1	601.0	2	1800.0	-3	25.2	24.8	34.7	22	1.6
SIGMA-ALDRICH SIAL	287.7	7	887.1	6	33.8	21	107.5	0	11.7	10.4	17.0	21	1.8
(C) HEALTH-CARE SERVICES													
GROUP COMPOSITE	32982.8	14	95950.8	13	1270.0	43	3508.8	87	3.9	3.1	12.7	26	1.4
APRIA HEALTHCARE GROUP AHG	284.0	12	838.9	11	19.1	29	53.5	28	6.7	5.9	31.2	18	1.2
BEVERLY ENTERPRISES BEV	690.9	4	2030.3	3	12.1	NM	-34.6	NM	1.7	NM	-14.9	NM	-0.7
COMMUNITY HEALTH SYSTEMS CYH	416.6	22	1216.1	26	10.0	698	30.5	NM	2.4	0.4	4.8	57	0.4
COVENTRY HEALTH CARE CVH	794.7	23	2332.8	24	21.7	41	60.7	50	2.7	2.4	12.2	18	1.2
EXPRESS SCRIPTS ESX	2349.8	35	6612.4	36	32.6	31	90.9	NM	1.4	1.4	13.6	30	1.3
HCA HCA	4438.0	8	13415.0	7	256.0	47	845.0	327	5.8	4.3	17.6	25	1.5
HEALTH MANAGEMENT ASSOCIATES HMA ⁽³⁾	491.2	20	1445.6	20	51.9	33	154.8	16	10.6	9.6	15.6	26	0.7
HEALTHSOUTH HRC	1075.9	1	3265.3	5	79.1	11	134.5	-33	7.4	6.7	5.8	25	0.5
HUMANA HUM	2611.0**	-1	7572.0	-6	30.0	30	82.0	30	1.1	0.9	7.7	18	0.6
LABORATORY CORP. OF AMERICA HOLDINGS LH	560.9	15	1636.0	14	46.3	41	141.9	56	8.3	6.7	15.7	37	2.3
MANOR CARE HCR	687.6	14	1989.2	13	31.2	53	86.4	435	4.5	3.4	10.3	22	1.0
PACIFICARE HEALTH SYSTEMS PHSY	2964.5	2	8968.9	4	16.1	209	44.5	-70	0.5	0.2	2.7	11	1.6
QUEST DIAGNOSTICS QGX	903.2	6	2717.3	5	50.1	74	133.0	73	5.5	3.4	13.0	41	1.6
RIGHTCHOICE MANAGED CARE RIT	304.5**	10	883.8	11	21.1	146	49.3	98	6.9	3.1	15.6	22	3.1
SIERRA HEALTH SERVICES SIE	376.3**	0	1090.2	5	-7.6	NM	-1.6	NM	NM	0.7	1.1	NM	0.0
TENET HEALTHCARE THC ⁽⁷⁾	3297.0	14	9542.0	10	224.0	45	573.0	148	6.8	5.3	14.2	25	2.2
TRIAO HOSPITALS TRI	829.5	175	1838.5	101	6.5	NM	-4.6	NM	0.8	NM	-0.5	NM	-0.2
UNITEDHEALTH GROUP UNH	5941.0**	11	17434.0	11	231.0	27	666.0	30	3.9	3.4	23.6	25	2.6
UNIVERSAL HEALTH SERVICES UHS	720.8**	28	2116.3	30	30.3	35	98.8	33	4.2	4.0	14.8	21	1.8
WELLPOINT HEALTH NETWORKS WLP	3245.5**	38	9006.3	33	108.4	21	304.9	21	3.3	3.8	19.5	19	6.0
(D) MEDICAL PRODUCTS													
GROUP COMPOSITE	16412.2	11	48810.7	9	2538.4	10	7057.5	4	15.5	15.5	21.7	36	1.3
BARO (C.R.) BCR	297.8	8	878.5	7	35.7	5	103.9	5	12.0	12.3	17.1	26	2.1
BAUSCH & LOMB BOL	433.6	-2	1259.9	-4	23.3	59	28.9	-67	5.4	3.3	2.2	76	0.4
BAXTER INTERNATIONAL BAX	1900.0	13	5527.0	11	272.0	18	739.0	58	14.3	13.7	29.6	29	1.6
BIOMET BMET ⁽⁷⁾	272.0	18	827.2	16	56.0	16	153.3	8	20.6	21.0	17.3	40	0.7
BOSTON SCIENTIFIC BSX	670.0	3	1996.0	-1	58.0	-32	-119.0	NM	8.7	13.0	-3.2	NM	0.1
GUIDANT GOT	661.6	10	1988.9	5	122.4	0	348.9	-5	18.5	20.4	28.9	35	1.1
INVACARE IVC	272.2	8	792.1	6	19.3	11	47.0	14	7.1	6.9	16.7	17	2.0
JOHNSON & JOHNSON JNJ	8238.0	11	24601.0	9	1529.0	16	4563.0	14	18.6	17.8	24.0	33	1.8
MEOTRONIC MOT ⁽⁸⁾	1455.7	11	4335.2	8	301.5	6	754.3	12	20.7	21.7	18.4	46	0.8
OWENS & MINOR OMI	968.2	11	2846.3	9	1.7	-80	18.8	19	0.2	1.0	12.5	22	0.8
ST. JUDE MEDICAL STJ	337.0	17	999.2	13	31.4	-17	122.3	39	9.3	13.2	14.9	39	1.8
STRYKER SYK	619.3	13	1892.5	13	60.6	21	190.4	23	9.8	9.1	24.9	45	1.2
ZIMMER HOLDINGS ZMH	286.7	14	867.0	13	27.4	-36	106.6	-17	9.6	16.9	NM	39	0.8
13 HOUSING & REAL ESTATE													
INDUSTRY COMPOSITE	28679.4	14	79470.8	11	1385.6	-8	3748.7	4	4.8	5.9	10.9	16	1.6
(A) BUILDING MATERIALS													
GROUP COMPOSITE	15733.7	3	44995.6	1	472.8	-49	1428.4	-34	3.0	6.1	8.2	31	0.8
AMERICAN STANDARD ASO	1885.0	-4	5715.0	-2	90.0	1	275.0	7	4.8	4.5	NM	13	4.5
OAL-TILE INTERNATIONAL OTL	269.0	9	778.0	8	20.5	26	57.0	23	7.6	11.2	31.1	11	1.4
HUGHES SUPPLY HUG ⁽¹¹⁾	806.3	8	2323.1	-4	14.7	-34	12.0	-75	1.8	2.6	5.3	18	1.3
LAFARGE NORTH AMERICA LAF	1140.1	23	2514.3	18	131.4	3	152.1	23	11.5	13.8	11.3	12	2.9

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 11-1	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
LENNOX INTERNATIONAL LII	826.8	-4	2391.2	-3	15.2	23	-2.1	NM	1.8	1.4	0.9	69	0.13
MARTIN MARIETTA MATERIALS MLM	499.7	16	1277.9	10	45.9	9	80.3	-12	9.2	9.8	10.1	19	2.12
MASCO MAS	2247.0	19	6243.0	13	-183.0	NM	71.0	-87	NM	9.9	3.1	82	0.25
MORTEK NTK	487.5	-1	1411.1	-1	6.9	-47	27.0	-28	1.4	2.6	10.1	8	2.67
OWENS CORNING OWC	1291.0	1	3597.0	-6	27.0	93	46.0	NM	2.1	1.1	NM	NM	-1.32
PPG INDUSTRIES PPG	1999.0	7	6262.0	-5	93.0	-38	304.0	-38	4.7	7.0	13.9	20	2.55
RPM RPM (7)	533.3	-4	1486.2	-2	36.6	27	53.8	27	6.9	5.2	10.6	18	0.70
TECUMSEH PRODUCTS TECUA	313.1	-10	1099.8	-15	5.2	-62	36.7	-28	1.7	4.0	5.3	17	2.75
USG USG	842.0	12	2474.0	16	27.0	-58	25.0	-91	3.2	6.8	NM	NM	-11.48
VALSPAR VAL (2)	544.9	42	1395.6	27	25.5	0	49.0	-21	4.7	6.6	11.2	21	1.64
VULCAN MATERIALS VMC	766.0	12	2095.6	13	92.2	7	177.6	-4	12.0	12.6	14.1	20	2.07
WATSCO WSO	336.0	-7	965.3	-5	8.1	-32	23.4	-15	2.4	3.3	4.6	23	0.56
YORK INTERNATIONAL YRK	946.9	0	2966.5	2	16.7	9	40.5	-52	1.8	1.6	8.4	19	1.62
(B) CONSTRUCTION & REAL ESTATE													
GROUP COMPOSITE	12945.7	30	34475.2	30	912.8	60	2320.3	60	7.1	5.8	12.5	10	2.48
BOSTON PROPERTIES BXP	265.7	19	757.3	18	43.0	13	147.7	37	16.2	17.1	10.7	17	2.08
CENTEX CTX (9)	1883.6**	17	5597.6	18	93.4	58	274.8	55	5.0	3.7	19.1	7	5.58
CHAMPION ENTERPRISES CH8	427.6	-8	1182.2	23	2.5	NM	-23.1	NM	0.6	NM	-62.4	NM	-3.61
CLAYTON HOMES CMH (8)	306.1	2	871.4	-8	26.5	-8	76.7	-25	8.7	9.6	9.1	20	0.75
EQUITY OFFICE PROPERTIES TRUST EOP	910.1	38	2270.0	38	217.4	89	484.4	36	23.9	17.5	5.3	18	1.63
HOST MARRIOTT HMT	852.0	258	2733.0	342	-6.0	NM	75.0	NM	NM	NM	25.2	5	1.35
HOVANNAN ENTERPRISES HOV (2)	509.9**	79	1206.9	54	21.0	160	42.0	180	4.1	2.8	16.9	5	2.36
KB HOME KBH (1)	1235.3	26	3123.3	16	60.4	35	125.7	-8	4.9	4.6	20.1	6	5.28
LENNAR LEN (1)	1577.6**	15	4073.2	36	106.7	75	255.0	113	6.8	4.4	24.4	7	5.27
M.O.C. HOLDINGS MOC	521.1	17	1448.5	19	40.5	18	108.7	29	7.8	7.7	24.3	5	6.03
MICHAEL BAKER CORP. MBO	266.8**	9	667.4	2	15.0	21	37.8	18	5.6	5.0	19.6	6	6.42
NVR NVR	694.5**	13	1890.4	12	62.5	42	169.8	52	9.0	7.1	72.6	8	22.08
PARTEC HOMES PHM	1481.9**	38	3379.8	19	83.2	37	182.9	38	5.6	5.7	12.4	6	5.91
RYLAND GROUP RYL	711.6	13	1913.3	21	41.7	83	91.7	81	5.9	3.6	23.5	6	8.64
SCHULER HOMES SHLR (9)	383.6	NA	844.1	NA	19.2	NA	46.3	NA	5.0	NA	13.7	9	1.78
STANFORD PACIFIC SPF	336.4	11	950.5	16	26.3	4	79.8	35	7.8	8.3	22.1	5	3.95
TOLL BROTHERS TOL (2)	581.8**	25	1566.3	31	59.4	60	145.1	66	10.2	8.0	23.2	6	5.24
(4) LEISURE TIME INDUSTRIES													
INDUSTRY COMPOSITE	32731.6	1	93700.1	2	1862.0	-26	4177.1	-36	5.7	7.7	7.6	30	0.77
(A) EATING PLACES													
GROUP COMPOSITE	9583.0	4	27795.5	3	829.9	3	2078.1	-10	8.7	8.7	18.8	20	1.37
BOB EVANS FARMS BOBE (8)	267.5	6	774.4	6	15.0	12	38.4	4	5.6	5.3	11.2	13	1.50
BRINKER INTERNATIONAL EAT (6)	690.5	17	1991.7	16	39.6	13	117.4	17	5.7	6.0	16.6	18	1.47
CBRL GROUP CBRL (5)	544.1	16	1496.4	11	2.6	-89	32.2	-28	0.5	5.0	5.8	29	0.87
CKE RESTAURANTS CKR (11)	340.7	-22	1166.4	-22	-36.8	NM	-222.2	NM	NM	NM	-91.3	NM	-4.98
DAROLD RESTAURANTS DRI (7)	1081.5	6	3152.5	7	62.2	9	172.7	7	5.7	5.6	18.9	19	1.65
McDONALD'S MCO	3879.3	3	11098.5	4	545.5	-1	1364.7	-11	14.1	14.6	19.7	19	1.39
OUTBACK STEAKHOUSE OSI	529.0	9	1589.1	11	25.4	-28	99.8	-9	4.8	7.3	14.9	17	1.69
TRICON GLOBAL RESTAURANTS YUM	1640.0	-1	4751.0	-3	124.0	110	328.0	15	7.6	3.6	NM	17	3.02
WENDY'S INTERNATIONAL WEN	610.4	6	1775.5	7	52.4	8	147.1	9	8.6	8.4	15.2	18	1.53
(B) ENTERTAINMENT													
GROUP COMPOSITE	7426.7	4	21506.5	9	-219.9	NM	-182.9	NM	NM	3.1	-5.3	NM	-0.75
AMC ENTERTAINMENT AEN (9)	377.1	14	976.2	10	19.0	NM	-56.4	NM	5.0	NM	-46.1	NM	-3.37
BLOCKBUSTER B8B	1264.7	6	3798.6	5	-224.9	NM	-235.8	NM	NM	NM	-4.4	NM	-1.48
BOYO GAMING BYD	273.4	3	835.1	-5	4.1	11	18.6	-72	1.5	1.4	4.0	20	0.23
HARRAH'S ENTERTAINMENT HET	1052.0	11	2865.5	10	61.8	-14	153.9	3	5.9	7.6	-0.5	NM	-0.09
HOLLYWOOD ENTERTAINMENT HLYW	344.9	13	1012.2	5	15.4	NM	25.7	NM	4.5	0.2	NM	NM	-9.36
ISLE OF CAPRI CASINOS ISLE (8)	262.9	12	776.3	29	5.9	-45	10.8	-63	2.2	4.5	12.0	14	0.67
OWENS CINEPLEX ENTERTAINMENT LCPFQ (10)	271.1**	2	693.7	1	-9.9	NM	-209.9	NM	NM	NM	NM	NM	-6.75
MANALAY RESORT GROUP MBG (11) †	614.4	1	1824.5	7	30.5	-20	81.3	0	5.0	6.2	10.5	12	1.45
METRO-GOLDWYN-MAYER MGM	393.3	26	1012.1	7	-16.0	NM	-94.8	NM	NM	8.7	-3.4	NM	-0.35
MGM MIRAGE MGG	984.0	-5	3083.1	49	-14.4	NM	146.9	50	NM	6.9	8.7	17	1.33
PARK PLACE ENTERTAINMENT PPE	1222.0	-2	3621.0	-1	-101.0	NM	-8.0	NM	NM	5.4	-0.4	NM	-0.05
TRUMP HOTELS & CASINO RESORTS OJT	366.9	-3	1008.2	-2	9.5	22	-15.1	NM	2.6	2.1	-44.2	NM	1.82
(C) HOTEL & MOTEL													
GROUP COMPOSITE	4021.0	-6	12696.0	0	152.0	-45	719.0	-11	3.8	6.4	11.5	15	1.26
HILTON HOTELS HLT	711.0	-18	2388.0	-7	21.0	-66	162.0	-22	3.0	7.2	13.8	15	0.61
MARRIOTT INTERNATIONAL MAR	2345.0	2	7219.0	5	101.0	-8	352.0	7	4.3	4.8	13.8	16	1.95
STARWOOD HOTELS & RESORTS HOT	965.0	-12	3089.0	-5	30.0	-71	205.0	-24	3.1	9.4	8.5	14	1.63
(D) OTHER LEISURE													
GROUP COMPOSITE	11700.8	-1	31702.1	-3	1100.0	-9	1562.9	-50	9.4	10.2	8.9	25	0.94
AMERICAN GREETINGS AM (10)	488.2	-1	1657.2	-3	-35.7	NM	-243.5	NM	NM	NM	-22.9	NM	-3.33
BRUNSWICK BC	811.0	-14	2653.0	-10	6.3	-64	87.3	-45	0.8	1.9	11.4	12	1.47

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTH EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
CARNIVAL CCL ⁽¹⁾	1489.9	21	3576.6	22	495.0	25	809.9	5	33.2	32.3	15.3	13	1.7
EASTMAN KODAK EK	3308.0	-8	9875.0	-5	96.0	-77	282.0	-77	2.9	11.6	14.6	16	1.0
FLEETWOOD ENTERPRISES FLE ⁽⁸⁾	564.1	-22	1626.3	-35	-11.1	NM	-260.6	NM	NM	NM	NM	NM	-8.0
HARLEY-DAVIDSON HDI	867.0**	20	2513.3	16	111.7	35	319.4	26	12.9	11.5	25.0	35	1.3
HASBRO HAS	893.4	-17	1867.6	-29	50.6	266	8.3	-77	5.7	1.3	-13.4	NM	-0.9
MATTEL MAT	1612.8	2	3199.0	3	199.8	93	172.9	166	12.4	6.5	17.3	29	0.6
POLARIS INDUSTRIES PI	431.1	7	1087.7	6	32.2	10	59.7	8	7.5	7.3	40.0	12	3.7
ROYAL CARIBBEAN CRUISES RCL	940.7	13	2489.3	12	159.2	-21	293.4	-29	16.9	24.1	8.7	7	1.6
TRANS WORLD ENTERTAINMENT TWMC ⁽¹¹⁾	294.6	3	1157.0	4	-4.0	NM	34.0	-55	NM	2.3	4.3	20	0.4
15 MANUFACTURING													
INDUSTRY COMPOSITE	57748.5	-2	173559.8	2	3097.5	-41	9686.9	-28	5.4	9.0	12.9	23	1.9
(A) GENERAL MANUFACTURING													
GROUP COMPOSITE	17813.6	3	53404.0	3	860.3	-29	2526.9	-28	4.8	7.0	13.7	27	2.0
AVERY DENNISON AVY	966.7	-3	2890.7	-2	61.7	-15	185.3	-14	6.4	7.3	27.2	19	2.5
CARLISLE CSL	462.4	4	1416.0	4	10.9	-61	17.3	-80	2.4	6.3	5.2	33	0.9
ENERGIZER HOLDINGS ENR ⁽³⁾	432.7	-10	1135.5	-9	-114.5	NM	-93.2	NM	NM	7.6	-5.4	NM	-0.4
FORTUNE BRANDS FO	1378.5	5	3941.5	-1	92.8	27	257.2	9	6.7	5.6	-5.4	NM	-0.6
HARSCO HSC	530.9	-2	1589.3	9	26.8	20	61.7	-13	5.1	4.1	12.7	15	2.1
HILLENBRAND INDUSTRIES HB ⁽¹⁾	514.0	4	1564.0	4	41.0	21	107.0	1	8.0	6.9	15.8	21	2.4
JOHNSON CONTROLS JCI ⁽³⁾	4649.1	14	13972.8	9	156.3	3	375.8	1	3.4	3.7	18.6	14	5.1
MINNESOTA MINING & MFG. MMM	3967.0	-7	12216.0	-3	394.0	-21	1049.0	-28	9.9	11.7	23.7	29	3.6
NCI BUILDING SYSTEMS NCS ⁽²⁾	259.1	-5	683.9	-7	7.1	-41	11.2	-61	2.7	4.4	8.3	9	1.4
NEWELL RUBBERMAID NWL	1767.8	1	5103.2	-1	83.5	-32	193.9	-41	4.7	7.0	11.9	26	1.0
PARKER HANNIFIN PH ⁽⁶⁾	1475.9	-1	4502.7	3	60.6	-52	201.4	-42	4.1	8.4	10.8	15	2.4
SHAW GROUP SGR ⁽⁴⁾	385.7	46	1120.2	83	19.3	90	49.1	100	5.0	3.8	10.6	18	1.4
TELEFLEX TFX	466.0	11	1439.8	10	22.1	2	83.1	7	4.7	5.2	15.1	14	2.9
TOWER AUTOMOTIVE TWR	557.8	4	1828.6	-4	-1.4	NM	28.2	-67	NM	1.9	-5.5	NM	-0.9
(B) MACHINE & HAND TOOLS													
GROUP COMPOSITE	3712.8	-6	11350.5	-7	75.3	-68	361.1	-45	2.0	5.8	11.8	19	1.7
BLACK & DECKER BDK	1063.0	-6	3112.4	-6	46.2	-46	121.0	-47	4.3	7.6	22.5	16	2.1
KENAMETAL KMT ⁽⁶⁾	406.7	-10	1317.4	-7	12.4	25	42.9	-1	3.1	2.2	7.1	20	1.8
NACCO INDUSTRIES NC	597.5	-15	1982.7	-5	-27.5	NM	-7.0	NM	NM	1.3	-0.2	NM	-0.10
SNAP-ON SNA	515.8**	-1	1588.8	-4	0.6	-98	38.9	-64	0.1	5.5	6.4	30	0.9
STANLEY WORKS SWK	676.1	-1	1978.8	-5	54.5	12	151.8	3	8.1	7.1	23.9	17	2.2
TEREX TEX	453.7	-5	1370.4	-16	-10.9	NM	13.5	-86	NM	10.5	4.9	21	0.79
(C) SPECIAL MACHINERY													
GROUP COMPOSITE	34576.4	-3	104173.4	4	2143.9	-43	6729.9	-26	6.2	10.5	12.7	22	1.92
AGCO AG	577.2	11	1768.6	4	0.4	-83	0.2	NM	0.1	0.5	0.9	92	0.13
APPLIED MATERIALS AMAT ⁽²⁾	1333.9	-51	5974.4	-10	28.5	-95	813.4	-42	2.1	22.1	19.0	21	1.73
CATERPILLAR CAT	5056.0	6	15354.0	2	205.0	-5	638.0	-19	4.1	4.5	15.3	17	2.60
CRANE CR	426.2	17	1214.5	7	17.9	-17	70.6	-27	4.2	5.9	15.2	13	1.62
CUMMINS CUM	1408.0	-10	4218.0	-15	9.0	-64	-99.0	NM	0.6	1.6	-19.0	NM	-5.90
DEERE DE ⁽²⁾	3584.3**	-1	10040.7	3	71.8	-58	256.1	-38	2.0	4.7	7.6	28	1.38
DOONALSON DCI ⁽⁵⁾	297.8	-1	847.1	0	22.8	24	58.7	10	7.7	6.1	23.7	19	1.66
DOVER DOV	1088.6	-22	3474.7	-14	2.6	-98	225.0	-44	0.2	10.4	14.2	19	1.76
FLOWERVE FLS	469.6	14	1378.2	38	5.8	NM	-0.1	NM	1.2	NM	0.6	NM	0.05
FMC FMC	956.8	0	2834.7	-5	21.3	-62	-299.4	NM	2.2	5.9	-41.5	NM	-8.07
ILLINOIS TOOL WORKS ITW	2395.6	-3	7302.6	-2	199.1	-25	614.6	-19	8.3	10.7	13.9	22	2.67
INGERSOLL-RAND IR	2383.1	-5	7146.4	0	33.9	-74	146.1	-67	1.4	5.2	6.5	25	1.55
ITT INDUSTRIES ITT	1123.6	-5	3493.9	-3	67.5	4	202.7	9	6.0	5.5	23.2	16	3.11
JLG INDUSTRIES JLG ⁽⁵⁾	281.6	-17	731.2	-13	5.6	-78	21.2	-55	2.0	7.7	10.3	13	0.80
JOY GLOBAL JOY ⁽²⁾	290.6	10	846.8	1	59.6	NM	46.9	NM	20.5	NM	9.5	NA	NA
LAM RESEARCH LRCX ⁽⁶⁾	339.6	11	1170.2	16	-8.9	NM	81.4	-50	NM	6.5	9.4	25	0.84
MANITOWOC MTW	301.0	40	828.6	25	12.4	1	40.2	-19	4.1	5.7	19.1	14	2.06
NOVELLUS SYSTEMS NVLS	303.7	4	1139.3	30	-14.0	NM	127.3	-12	NM	14.8	11.9	23	1.54
PENTAIR PNR	646.6	-7	2020.0	-3	24.7	-12	73.8	-26	3.8	4.1	5.2	29	1.12
STEWART & STEVENSON SERVICES SSSS ⁽¹¹⁾	390.4	46	1070.8	31	13.0	67	44.9	122	3.3	2.9	13.6	8	1.86
TIMKEN TTK	577.7	-9	1873.6	-7	-30.5	NM	-42.9	NM	NM	1.2	-4.6	NM	-0.69
TORO TTC ⁽²⁾	329.8**	-4	1076.8	1	16.9	3	48.3	9	5.1	4.8	14.1	12	3.76
TYCO INTERNATIONAL TYC ⁽³⁾	10014.8	5	28368.2	18	1379.5	-28	3661.9	-3	13.8	20.0	14.6	20	2.55
(D) TEXTILES													
GROUP COMPOSITE	1645.8	-1	4631.9	-4	18.1	-75	69.0	-10	1.1	4.3	22.0	25	0.70
INTERFACE IFSIA	263.1	-22	856.9	-10	-41.3	NM	-35.6	NM	NM	2.9	-8.1	NM	0.52
MOHAWK INDUSTRIES MHK	869.7	4	2441.7	-1	55.7	32	129.4	5	6.4	5.0	19.1	14	3.18
WESTPOINT STEVENS WXS	513.1	5	1333.3	5	3.6	82	24.8	NM	0.7	4.1	NM	NM	-0.68

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENOING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTHS EARNINGS PER SHARE
	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 %	3QO QUARTER 2000 %			
6 METALS & MINING													
INDUSTRY COMPOSITE	17723.7	-12	55767.3	-4	137.0	-73	-414.4	NM	0.8	2.6	-0.8	NM	-0.10
(A) ALUMINUM													
GROUP COMPOSITE	6445.4	-14	20600.1	3	436.8	31	1222.3	11	6.8	4.5	15.0	17	1.74
ALCDA AA	5511.0	-12	17678.0	8	339.0	-8	1050.0	-4	6.2	5.8	13.4	20	1.67
KAISER ALUMINUM KLU	430.3	-21	1357.4	-19	68.4	NM	123.9	NM	15.9	NM	57.4	1	1.69
MAXXAM MXM	504.1	-18	1564.7	-17	29.4	NM	48.4	NM	5.8	NM	128.8	2	11.15
(B) STEEL													
GROUP COMPOSITE	7609.5	-8	22919.2	-11	-275.9	NM	-1691.3	NM	NM	1.0	-24.9	NM	-3.14
AK STEEL HOLDING AKS	1000.1	-12	3021.1	-15	-5.9	NM	-16.0	NM	NM	3.6	-0.1	NM	-0.02
BETHLEHEM STEEL BS	825.4	-17	2614.4	-19	-152.2	NM	-1402.5	NM	NM	NM	NM	NM	-12.00
COMMERCIAL METALS CMC (4)	646.3	-9	1846.7	-10	14.2	12	26.6	-26	2.2	1.8	5.6	16	1.85
NATIONAL STEEL NS	637.0	-8	1899.6	-18	-150.8	NM	-387.0	NM	NM	NM	NM	NM	-11.39
NUCOR NUE	1053.1	-9	3159.7	-12	20.5	-70	86.5	-63	1.9	5.8	7.6	19	2.14
RYERSON TULL RT	542.9	22	1763.7	-21	-11.6	NM	-15.2	NM	NM	NM	-5.2	NM	-1.39
TEXAS INDUSTRIES TXI (7)	365.3	-1	967.1	-7	5.0	-80	-4.4	NM	1.4	6.9	0.8	NM	0.25
USX-U.S. STEEL GROUP X	1645.0	13	4888.0	5	-23.0	NM	-44.0	NM	NM	1.3	-10.3	NM	-2.17
WALTER INDUSTRIES WLT	484.9	-7	1464.9	-2	13.6	NM	34.1	NM	2.8	0.0	17.0	14	0.77
WORTHINGTON INDUSTRIES WOR (7)	409.6	-15	1294.1	-14	14.3	14	30.5	-47	3.5	2.6	5.8	30	0.44
(C) OTHER METALS													
GROUP COMPOSITE	3668.8	-15	12248.0	-3	-23.8	NM	54.6	-78	NM	2.2	2.5	95	0.22
ENGELHARD EC	1143.1**	-18	4225.9	6	57.7	12	165.0	-2	5.1	3.7	16.3	21	1.24
FREEPORT-McMDRAN COPPER & GOLD FCX	441.2	-7	1426.6	7	13.4	NM	106.0	991	3.0	0.0	NM	12	0.93
GENERAL CABLE BGC	389.5	-12	1291.1	-5	1.4	-92	34.1	-19	0.4	3.9	43.9	8	1.37
NEWMONT MINING NEM	424.4	1	1210.9	-6	23.4	NM	-45.4	NM	5.5	NM	-2.2	NM	-0.14
OLIN OLN	333.6	-19	992.3	-17	-19.4	NM	-10.4	NM	NM	5.7	1.7	NM	0.10
PHELPS DOOGEE PO	937.0	-21	3101.2	-9	-100.4	NM	-194.7	NM	NM	3.3	-6.8	NM	-2.38
7 NONBANK FINANCIAL													
INDUSTRY COMPOSITE	167014.2	-3	517802.9	3	10315.0	-39	38922.6	-23	6.2	9.8	13.3	20	2.13
(A) FINANCIAL SERVICES													
GROUP COMPOSITE	98125.0	-6	311498.9	3	7971.0	-25	28303.5	-15	8.1	10.3	18.1	18	2.34
AMERICAN EXPRESS AXP	5724.0	-4	16711.0	-5	298.0	-60	1014.0	-52	5.2	12.3	14.4	24	1.26
AMERICREDIT ACF (6)	277.8	64	738.1	65	78.7	86	210.9	89	28.3	25.0	22.9	5	2.96
BEAR STEARNS BSC (1)	2301.8	-4	6887.4	-9	134.6	-26	470.0	-19	5.8	7.5	14.4	12	4.59
BLDCK (H&R) HRB (8)	324.1	7	2684.1	11	-30.8	NM	347.4	23	NM	NM	27.7	22	1.59
CAPITAL ONE FINANCIAL COF	1866.9	31	5272.4	37	165.3	35	464.3	36	8.9	8.6	19.9	16	2.72
CITIGRUP C	27714.0	-3	85372.0	3	3177.0	-9	10409.0	-3	11.5	12.2	19.1	18	2.53
CDNCORD EFS CEFT	437.1	20	1233.4	23	81.5	62	126.6	-12	18.6	13.8	11.4	74	0.38
CDUNTRYWIDE CREDIT INDUSTRIES CCR (10)	1566.6	59	4141.1	59	149.2	64	376.5	37	9.5	9.3	12.1	11	3.85
DUN & BRADSTREET ONB	290.5	-13	968.8	-7	29.1	310	96.7	75	10.0	2.1	NM	23	1.39
E*TRADE GROUP ET	488.1**	-10	1565.2	-3	-259.0	NM	-278.5	NM	NM	8.8	-15.4	NM	-0.86
EDWARDS (A.G.) AGE (10)	605.4	-15	1878.9	-20	41.0	-47	132.2	-54	6.8	10.9	11.5	17	2.32
EQUIFAX EFX	282.4	-13	857.1	-5	35.8	-7	108.2	9	12.7	11.8	36.6	18	1.28
FANNIE MAE FNM	12693.3	13	37494.1	17	1364.0	21	4038.7	24	10.7	10.0	44.2	16	5.04
FIDELITY NATIONAL FINANCIAL FNF	1002.6	27	2742.0	42	84.1	124	218.9	209	8.4	4.8	16.2	8	2.97
FIRST AMERICAN FAF	983.0**	31	2677.8	23	41.7	71	115.0	128	4.2	3.3	14.4	9	2.06
FRANKLIN RESDURCES BEN (3)	603.9**	2	1790.8	1	83.9	-40	335.3	-21	13.9	23.7	12.2	17	1.91
GOLDMAN SACHS GROUP GS (1)	7360.0	-17	25020.0	0	468.0	-43	1813.0	-26	6.4	9.3	13.4	18	4.49
HELLER FINANCIAL HF	460.0	-11	1431.0	-4	81.0	13	228.0	5	17.6	13.9	11.8	NA	2.77
HDOUSEHOLD INTERNATIDNAL HI	3504.5	14	10272.1	18	503.8	12	1374.6	14	14.4	14.6	23.5	13	3.94
INSTINET GROUP INET	320.5	-8	1146.1	10	8.2	-75	99.0	-12	2.6	9.4	9.9	16	0.62
LANDAMERICA FINANCIAL GROUP LFG	541.1	20	1533.3	16	18.8	139	53.9	129	3.5	1.7	-7.5	NM	-4.97
LEGG MASON LM (9)	373.0	-1	1134.0	-4	30.4	-18	103.1	-19	8.1	9.9	14.9	20	2.13
LEHMAN BROTHERS HOLDINGS LEH (1)	5057.0	-31	18093.0	-10	309.0	-32	1125.0	-18	6.1	6.2	19.3	12	5.38
MERRILL LYNCH MER	8929.0	-18	31183.0	-6	422.0	-52	1837.0	-37	4.7	8.2	13.2	16	2.86
METRIS MXT	462.4	23	1310.0	23	70.7	46	189.5	26	15.3	12.9	29.3	7	2.42
MDRGAN STANLEY DEAN WITTER MWD (1)	10431.0	-11	35900.0	3	735.0	-41	2740.0	-35	7.0	10.6	19.9	15	3.47
RAYMDND JAMES FINANCIAL RJF (3)	379.8	-12	1236.8	-6	12.6	-66	64.2	-35	3.3	8.6	12.6	15	1.98
SCHWAB (CHARLES) SCH	1224.0**	-27	4084.0	-25	13.0	-91	91.0	-84	1.1	8.4	5.3	88	0.15
STEWART INFORMATION SERVICES STC	338.7**	42	897.3	34	13.0	640	31.5	NM	3.8	0.7	8.4	10	2.00
STILWELL FINANCIAL SV †	361.6	-41	1221.6	-29	26.8	-84	228.6	-55	7.4	27.9	30.1	13	1.65
TD WATERHOUSE GROUP TWE (2)	256.6**	-26	886.6	-27	-21.8	NM	21.7	-87	NM	10.0	2.9	56	0.17
USA EDUCATION SLM	964.4	-13	3135.9	3	-193.5	NM	118.1	-68	NM	8.3	15.1	67	1.22
(B) INSURANCE													
GROUP COMPOSITE	59158.2	0	176369.9	1	874.3	-84	6357.4	-56	1.5	9.0	6.6	35	1.49
AFLAC AFL	2446.0	-1	7194.0	0	193.0	18	525.0	1	7.9	6.6	12.7	20	1.27
ALLSTATE ALL	7173.0	-4	21507.0	-2	226.0	-65	903.0	-46	3.2	8.7	8.3	16	2.00
AMERICAN INTERNATIONAL GROUP AIG	14001.0**	15	40887.6	11	408.0	-76	3633.2	-25	2.9	13.9	11.9	40	2.01

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO 11-1	12 MONTH EARNING PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
AMERICAN NATIONAL INSURANCE ANAT	544.5	15	1579.5	12	-4.5	NM	73.6	-48	NM	8.1	2.4	30	2.70
BERKLEY (W.R.) BER	500.1	12	1440.2	11	-47.2	NM	-27.4	NM	NM	1.6	-1.1	NM	-0.27
CIGNA CI	4778.0	-5	14173.0	-5	270.0	-3	798.0	12	5.7	5.5	20.4	10	7.02
CINCINNATI FINANCIAL CINF	643.9	7	1907.1	9	35.7	538	157.3	-1	5.5	0.9	2.0	55	0.77
CNA FINANCIAL CNA	3149.0**	-27	9495.0	-19	-155.0	NM	-156.0	NM	NM	12.7	-18.0	NM	-7.42
COMMERCE GROUP CGI	294.6	0	857.4	6	22.1	-38	65.0	-15	7.5	12.2	14.9	11	3.54
CONSECO CNC	1786.2	-9	6066.2	-1	-408.2	NM	-345.1	NM	NM	NM	-16.5	NM	-2.22
HARTFORD FINANCIAL SERVICES GROUP HIG	3722.0	-2	11291.0	5	-103.0	NM	397.0	-43	NM	6.6	7.9	19	2.89
JEFFERSON-PILOT JP	845.4	5	2530.1	4	133.6	3	416.4	5	15.8	16.0	16.1	12	3.43
JOHN HANCOCK FINANCIAL SERVICES JHF	1740.8	3	5590.2	3	171.1	-7	519.8	-15	9.8	10.9	12.3	14	2.47
LINCOLN NATIONAL LNC	1590.3**	-7	4888.1	-4	119.1	-14	421.0	-11	7.5	8.1	11.6	15	2.94
LOEWS LTR	4675.6**	-16	13787.0	-9	165.7	-76	-723.9	NM	3.5	12.2	-2.3	NM	-1.15
MARKEL MKL	378.3	27	1011.1	33	-91.0	NM	-82.0	NM	NM	NM	-9.9	NM	-10.92
MBIA MBI	290.8	9	846.1	8	154.5	18	426.7	9	53.1	49.1	11.8	12	3.78
MERCURY GENERAL MCY	382.7	12	1103.4	9	32.1	17	83.2	0	8.4	8.0	10.3	21	2.08
MGIC INVESTMENT MTG	339.8**	20	999.9	22	159.0	9	478.1	17	46.8	51.8	22.0	10	5.62
NATIONWIDE FINANCIAL SERVICES NFS	790.3**	-2	2401.3	0	132.6	14	361.3	11	16.8	14.5	13.5	10	3.67
OHIO CASUALTY OCAS	498.4	12	1416.9	9	44.2	204	56.8	NM	8.9	3.3	4.3	19	0.78
OLO REPUBLIC INTERNATIONAL ORI	599.5	16	1736.3	15	82.5	3	258.0	26	13.8	15.5	13.5	9	2.91
PROGRESSIVE PGR	1858.0	6	5487.2	10	96.4	64	286.7	NM	5.2	3.4	10.8	32	4.47
REINSURANCE GROUP OF AMERICA RGA	458.1	14	1417.3	16	9.0	-71	61.1	-20	2.0	7.8	10.2	18	1.80
SAFECO SAFC	1714.7**	-3	5201.6	-4	-156.0	NM	-1053.9	NM	NM	2.4	-28.2	NM	-8.13
ST. PAUL SPC	2230.5**	20	6555.0	10	-595.2	NM	-290.5	NM	NM	11.8	-1.4	NM	-0.55
STANCORP FINANCIAL GROUP SFG	399.5	9	1177.2	10	25.8	8	78.0	1	6.5	6.5	10.1	15	3.05
TRANSATLANTIC HOLOINGS TRH	542.4	9	1535.0	8	-77.8	NM	12.4	-92	NM	10.8	3.4	70	1.21
UICI UCI	276.2	8	829.9	3	11.9	32	36.6	4	4.3	3.5	5.7	25	0.64
UNITRIN UTR	508.6	3	1458.3	-2	20.1	NM	393.0	523	4.0	NM	21.4	7	6.20
(C) SAVINGS & LOAN													
GROUP COMPOSITE	9731.1	7	29934.1	16	1469.7	64	4261.6	50	15.1	9.9	16.2	10	2.75
ASTORIA FINANCIAL ASFC	385.6**	-3	1169.5	-2	56.5	5	170.3	3	14.6	13.5	14.0	11	4.54
CHARTER ONE FINANCIAL CF	729.1**	8	2119.0	9	130.4	19	365.6	13	17.9	16.2	16.2	13	2.12
OIIME BANCORP DME	595.4**	20	1852.6	18	96.9	NM	276.7	233	16.3	NM	17.4	11	2.86
GOLDEN STATE BANCORP GSB	1074.5**	-8	3329.5	-1	103.3	17	301.8	17	9.6	7.6	16.1	9	2.73
GOLDEN WEST FINANCIAL GDW	1084.5**	3	3426.6	22	205.8	50	590.8	49	19.0	13.0	18.3	10	4.68
GREENPOINT FINANCIAL GPT	506.9**	24	1402.2	19	103.2	54	267.5	41	20.4	16.4	12.6	10	3.25
SOVEREIGN BANCORP SOV	665.5**	2	2035.2	20	8.6	NM	49.9	NM	1.3	NM	2.2	53	0.19
WASHINGTON MUTUAL WM	4428.1**	11	13832.9	19	756.9	67	2196.1	57	17.1	11.3	18.5	9	3.16
WESTCORP WES	261.4**	27	766.6	43	8.2	-55	42.8	-23	3.1	8.8	11.7	9	1.84
18 OFFICE EQUIPMENT & COMPUTERS													
INDUSTRY COMPOSITE	119681.6	-12	383066.3	-3	506.6	-95	6435.4	-80	0.4	7.4	4.2	73	0.39
(A) BUSINESS MACHINES & SERVICES													
GROUP COMPOSITE	9863.8	-14	31890.7	-5	234.7	-49	1061.8	-13	2.4	4.0	17.6	17	1.68
COMPUCOM SYSTEMS CMPC	404.8	-44	1447.8	-28	1.2	-77	5.0	NM	0.3	0.7	5.4	9	0.25
OELUXE DLX	323.5	2	957.1	-21	51.1	9	137.9	5	15.8	14.9	124.8	14	2.49
OIEBOLO DBD	444.6	-7	1252.1	-1	14.3	-59	49.6	-51	3.2	7.3	9.4	31	1.19
HON INDUSTRIES HNI	459.4	-14	1365.5	-11	28.7	-16	51.1	-38	6.2	6.4	13.1	19	1.26
MILLER (HERMAN) MLHR (7)	410.3	-25	1482.3	-7	-2.9	NM	62.9	-41	NM	6.6	31.3	16	1.36
NCR NCR	1442.0	-2	4317.0	4	-6.0	NM	150.0	70	NM	3.7	12.3	15	2.40
PITNEY BOWES PBI	1044.5	9	3031.7	4	122.1	-16	413.9	-3	11.7	15.2	43.6	17	2.22
STEELCASE SCS (10)	792.5	-23	2640.1	-10	6.5	-88	56.1	-65	0.8	5.2	6.7	17	0.73
TECH OATA TECO (11)	4136.6	-17	14133.6	-4	14.0	66	98.5	-14	0.3	0.8	12.2	17	2.56
WALLACE COMPUTER SERVICES WCS (5)	405.6	-5	1263.5	2	5.9	-44	36.7	809	1.4	2.5	9.2	12	1.30
(B) COMPUTERS & PERIPHERALS													
GROUP COMPOSITE	61853.0	-16	200619.8	-6	-878.4	NM	3509.7	-76	NM	7.2	8.8	55	0.45
APPLE COMPUTER AAPL (3)	1450.0	-22	4356.0	-23	66.0	-61	170.0	-72	4.6	9.1	0.9	NM	-0.11
COMPAQ COMPUTER CPQ	7476.0	-33	25126.0	-19	-499.0	NM	-700.0	NM	NM	5.0	12.2	NM	0.80
OELL COMPUTER DELL (11)	7611.0	-1	24313.0	12	-101.0	NM	795.0	49	NM	7.9	29.7	45	0.54
EMC EMC	1212.3	-47	5577.9	-11	-945.2	NM	437.6	NM	NM	20.1	1.6	NM	0.05
GATEWAY GTW	1409.8	-45	4944.1	-31	-519.7	NM	-1019.5	NM	NM	5.2	85.6	NM	3.55
HEWLETT-PACKARO HWP (2)	10147.0	-14	33702.0	-5	103.0	-90	463.0	82	1.0	8.7	10.0	25	0.69
INTERNATIONAL BUSINESS MACHINES IBM	20428.0	-6	63040.0	0	1595.0	19	5390.0	1	7.8	9.0	36.0	24	4.51
LEXMARK INTERNATIONAL LXX	1003.5	8	2990.8	10	70.0	6	236.8	3	7.0	7.1	27.1	22	2.19
MAXTOR MXO	1045.0	69	2717.4	37	165.7	NM	484.2	NM	NM	NM	44.5	NM	2.42
QUANTUM OLT & STORAGE SYSTEMS DSS (6)	281.9	-22	869.8	20	-18.4	NM	-28.1	NM	NM	12.2	3.3	78	0.11
SILICON GRAPHICS SGI (6)	379.4	-11	1320.6	-13	69.6	NM	442.6	NM	NM	NM	NM	NM	2.68

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES			PROFITS				MARGINS			RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 11-1	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
STORAGE TECHNOLOGY STK	498.0	2	1479.0	1	17.9	186	27.2	NM	3.6	1.3	5.9	36	0.56
SUN MICROSYSTEMS SUNW (6)	2861.0	-43	10951.0	-22	-180.0	NM	-132.0	NM	NM	10.1	2.8	NM	0.07
SYMBOL TECHNOLOGIES S8L	331.2	-11	1121.6	8	-36.5	NM	-68.1	NM	NM	10.9	-21.1	NM	-1.12
UNISYS UIS	1376.0	19	4461.2	-10	20.9	-51	119.5	-42	1.5	2.5	7.0	19	0.50
WESTERN DIGITAL WDC (6)	440.9	4	1408.4	0	-4.0	NM	-56.7	NM	NM	NM	NM	NM	-0.29
KEROX XRX	3902.0	-13	12241.0	-11	-212.0	NM	-323.0	NM	NM	NM	-13.1	NM	-0.63

(C) COMPUTER SOFTWARE & SERVICES

GROUP COMPOSITE	47964.9	-4	150555.8	2	1150.2	-73	1863.9	-89	2.4	8.4	2.4	97	0.31
ADOBE SYSTEMS ADBE (1)	292.1	-11	965.2	6	40.3	-49	171.4	-18	13.8	23.8	37.4	27	1.00
AFFILIATED COMPUTER SERVICES ACS (6)	655.0	37	1739.1	15	43.9	44	115.7	31	6.7	6.4	15.6	34	2.66
AMERICAN MANAGEMENT SYSTEMS AMSY	281.4	-13	923.4	-3	1.8	NM	11.9	-56	0.6	NM	7.7	20	0.68
AOL TIME WARNER AOL	9320.0	6	27602.0	6	-996.0	NM	-3099.0	NM	NM	NM	-1.8	NA	NA
AUTOMATIC DATA PROCESSING ADP (6)	1607.9	4	5355.3	7	196.6	7	740.5	9	12.2	11.9	20.2	36	1.48
BEA SYSTEMS BEAS (11)	267.8	44	781.0	60	24.0	956	63.5	NM	8.9	1.2	10.0	69	0.17
BMC SOFTWARE BMC (9)	293.8	-9	1055.8	-10	-53.3	NM	-64.8	NM	NM	NM	-2.6	NM	-0.18
CAEAGENCE DESIGN SYSTEMS CDN	360.0	8	1052.2	18	127.4	832	102.4	NM	35.4	4.1	15.5	41	0.55
CERIDIAN CEN	280.9	1	880.6	1	20.6	1	26.7	-41	7.3	7.3	5.2	40	0.41
CISCO SYSTEMS CSCO (5)	4298.0	-25	15774.0	5	7.0	-99	-1812.0	NM	0.2	13.9	-3.7	NM	-0.14
COMPUTER ASSOCIATES INTERNATIONAL CA (9)	734.0	-52	2180.0	-52	-291.0	NM	-1043.0	NM	NM	8.9	-26.8	NM	-2.39
COMPUTER SCIENCES CSC (9)	2765.3	11	8376.0	11	68.2	-37	78.5	-77	2.5	4.4	-4.4	40	0.84
COMPUWARE CPWR (9)	424.0	-13	1385.3	-12	26.5	106	107.5	29	6.3	2.7	9.9	27	0.38
DST SYSTEMS DST	420.8	25	1243.4	23	48.6	8	176.9	19	11.5	13.4	17.4	22	1.91
EARTHLINK ELNK	319.0	28	917.7	31	-77.0	NM	-267.1	NM	NM	NM	-40.6	NM	-3.07
ELECTRONIC DATA SYSTEMS EDS	5559.0	16	15637.0	11	212.0	-24	982.0	19	3.8	5.8	22.4	24	2.72
FIRST DATA FDC	1612.7**	12	4652.5	11	151.2	-51	586.8	-15	9.4	21.4	24.2	34	2.06
FISERV FISV	467.2	15	1393.7	14	52.6	18	155.4	17	11.3	11.0	14.1	37	1.04
FORMATION IMN	279.3	-4	862.6	-7	10.1	NM	24.9	NM	3.6	NM	3.5	31	0.68
GRAM MICRO IM	5833.4	-23	19044.2	-16	-13.3	NM	3.7	-98	NM	0.5	3.3	32	0.42
MICROSOFT MSFT (6)	6126.0	6	19106.0	11	1283.0	-50	3799.0	-48	20.9	44.8	13.2	54	1.15
ORACLE ORCL (7)	2242.0	-1	8180.3	1	510.6	2	1948.3	-68	22.8	22.1	41.3	31	0.45
PEOPLESFT PSFT	509.4	15	1545.1	25	50.3	-27	133.8	32	9.9	15.5	12.5	57	0.56
PEROT SYSTEMS PER	307.0	11	893.0	9	-18.1	NM	-9.2	NM	NM	4.4	-3.3	NM	-0.16
SABRE HOLDINGS TSG	524.8**	6	1680.3	14	17.3	-57	22.8	-83	3.3	8.1	-0.6	NM	-0.06
SIEBEL SYSTEMS SEBL	428.5	-14	1567.0	29	35.2	-48	188.7	32	8.2	13.6	15.9	34	0.52
SOFTWARE SPECTRUM SPSE (6)	288.3	9	991.7	22	0.3	-15	3.7	9	0.1	0.1	4.6	13	0.81
SUNGARO DATA SYSTEMS SOS	463.3	12	1366.3	14	62.2	12	180.5	20	13.4	13.4	14.3	29	0.86
TECOM COMS (7)	389.6	-58	1487.2	-48	-232.4	NM	-996.2	NM	NM	NM	-50.0	NM	-3.32
TITAN TTN	274.2	2	800.1	9	3.5	-47	-22.1	NM	1.3	2.4	-9.6	NM	-0.43
VERITAS SOFTWARE VRTS	340.2	7	1117.9	34	-162.0	NM	-447.1	NM	NM	NM	-21.1	NM	-1.43

(9) PAPER & FOREST PRODUCTS

INDUSTRY COMPOSITE	26333.3	-3	79318.6	1	165.7	-86	1026.7	-74	0.6	4.4	3.3	61	0.67
(A) FOREST PRODUCTS													
GROUP COMPOSITE	7649.1	13	23171.3	11	-167.8	NM	-311.0	NM	NM	1.6	-7.0	NM	-1.49
GEORGIA-PACIFIC GROUP GP	6306.0	16	19226.0	16	-182.0	NM	-289.0	NM	NM	2.4	-8.8	NM	-2.25
LOUISIANA-PACIFIC LPX	635.5	-10	1843.8	-22	-1.6	NM	-100.7	NM	NM	NM	-13.0	NM	-1.46
RAYONIER RYN	274.9	2	897.8	-3	6.0	-50	49.7	-24	2.2	4.5	8.9	19	2.28
UNIVERSAL FOREST PRODUCTS UFPI	432.7	17	1203.7	9	9.8	20	29.0	7	2.3	2.2	12.3	11	1.59

(B) PAPER

GROUP COMPOSITE	18684.2	-8	56147.3	-3	333.5	-69	1337.6	-60	1.8	5.4	5.7	38	1.18
BOISE CASCADE BCC	1874.4	-5	5665.5	-5	15.0	-82	-0.8	NM	0.8	4.3	0.7	NM	0.16
BOWATER BOW	558.8	-17	1748.9	-5	-1.8	NM	54.5	-46	NM	7.4	5.5	21	2.17
INTERNATIONAL PAPER IP	6529.0	-16	20109.0	-4	-275.0	NM	-570.0	NM	NM	2.2	-8.2	NM	-1.85
KIMBERLY-CLARK KMB	3710.0	5	10852.6	5	419.4	-5	1268.2	-6	11.3	12.5	29.2	17	3.23
MEAO MEA	1145.2	-6	3241.6	-2	19.2	-68	13.6	-91	1.7	4.9	1.3	91	0.30
MEYERHAEUSER WY	3742.0	-5	11137.0	-7	91.0	-54	369.0	-43	2.4	5.1	8.1	20	2.56
MILLAMETTE INDUSTRIES WLL	1124.8	-4	3392.8	-4	65.8	-21	203.2	-22	5.8	7.1	11.5	18	2.63

(20) PUBLISHING & BROADCASTING

INDUSTRY COMPOSITE	20242.4	2	60597.9	19	-72.9	NM	1379.9	-50	NM	13.4	1.9	94	0.39
(A) BROADCASTING													
GROUP COMPOSITE	11380.1	9	33808.9	37	-191.6	NM	268.0	-29	NM	18.8	0.9	NM	0.19
COMCAST CMCSK	2355.5	20	6850.1	18	-106.8	NM	546.6	-57	NM	63.7	9.0	26	1.38
COX COMMUNICATIONS COX	1032.0	14	2981.7	NA	143.0	-83	143.1	NA	13.9	92.9	0.7	NM	0.11
ECHOSTAR COMMUNICATIONS DISH	1022.5	46	2850.7	49	3.1	NM	-172.6	NM	0.3	NM	NM	NM	-0.69
USA NETWORKS USAI	1256.3	13	3943.5	20	40.4	NM	68.1	NM	NM	NM	3.7	NM	0.36
VIACOM VIA.B	5713.8	-2	17182.9	26	-190.4	NM	-181.0	NM	NM	0.6	0.2	NM	0.06

CORPORATE SCOREBOARD

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	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
(B) PUBLISHING													
GROUP COMPOSITE	8862.2	-5	26789.0	1	118.7	-83	1111.9	-53	1.3	7.4	6.4	49	0.86
BELO BLC	322.5	-17	1015.9	-13	-0.5	NM	-0.2	NM	NM	4.5	6.5	24	0.74
DOW JONES DJ	397.6	-21	1341.6	-18	16.7	NM	66.1	-57	4.2	NM	NM	NM	-2.3
GANNETT GCI	1517.9	-3	4720.1	9	174.8	-16	582.8	-14	11.5	13.4	16.4	19	3.3
KNIGHT-RIDDER KRI	693.1	-10	2167.0	-7	55.7	-27	109.8	-67	8.0	9.9	5.4	57	0.9
McCLATCHY MNI	263.8	-5	803.3	-3	14.2	-34	37.1	-40	5.4	7.7	6.5	30	1.4
McGRAW-HILL MHP	1535.1	10	3531.0	11	239.5	11	379.9	4	15.6	15.5	24.8	22	2.4
NEW YORK TIMES NYT	696.9	-9	2235.3	-9	43.8	-40	128.1	-49	6.3	9.5	19.8	24	1.6
PRIMEDIA PRM	418.6	4	1290.9	5	-277.9	NM	-503.4	NM	NM	NM	NM	NM	-4.2
READER'S DIGEST ASSOCIATION RDA (6)	497.5	-10	1639.9	-5	-1.1	NM	4.9	-91	NM	4.0	25.2	18	1.0
SCHOLASTIC SCHL (7)	306.1	-15	1238.0	16	-31.8	NM	-41.2	NM	NM	NM	3.3	NM	0.4
SCRIPPS (E.W.) SSP	342.1	-17	1083.5	-14	22.6	-36	128.4	12	6.6	8.6	12.9	29	2.2
TRIBUNE TRB	1275.5	-7	3935.5	14	-138.9	NM	4.4	-98	NM	5.8	0.3	NM	0.0
WASHINGTON POST WPO	595.5	-1	1787.0	3	1.6	-95	215.1	118	0.3	5.6	15.1	19	26.52
21 SERVICE INDUSTRIES													
INDUSTRY COMPOSITE	49171.5	-4	148749.8	1	697.3	-58	3211.7	-28	1.4	3.2	10.1	24	0.82
(A) CONSTRUCTION & ENGINEERING													
GROUP COMPOSITE	5564.7	2	16332.8	1	156.6	16	406.8	8	2.8	2.5	12.1	23	1.13
EMCOR GROUP EME	848.6	-8	2555.7	1	15.3	33	32.6	27	1.8	1.2	11.7	12	3.28
FLUOR FLR	2198.6	1	6337.2	-7	44.8	59	96.4	21	2.0	1.3	14.0	NA	NA
IT GROUP ITX	367.2	-4	1065.3	2	0.5	-93	7.6	-58	0.1	1.8	-5.8	NM	-0.67
JACOBS ENGINEERING GROUP JEC (3)	976.5	12	3027.8	16	23.6	21	67.7	19	2.4	2.2	14.8	21	3.2
REPUBLIC SERVICES RSG	582.6	8	1694.0	8	56.8	3	164.5	0	9.7	10.2	12.6	13	1.28
URS URS (2)	591.2	6	1652.8	3	15.7	11	38.0	12	2.7	2.5	15.1	10	2.33
(B) INDUSTRIAL DISTRIBUTION													
GROUP COMPOSITE	14038.7	-16	45399.3	-5	-0.6	NM	306.3	-74	NM	2.6	5.8	32	0.71
AIRGAS ARG (9)	412.0	0	1242.5	1	14.6	40	29.3	41	3.5	2.5	7.7	25	0.53
APPLIED INDUSTRIAL TECHNOLOGIES AIT (6)	368.0	-13	1167.4	-7	4.9	-32	18.3	-30	1.3	1.7	8.4	13	1.30
ARROW ELECTRONICS ARW	2182.6	-35	7968.3	-14	-159.1	NM	-80.5	NM	NM	3.1	1.5	94	0.27
AUDIOVOX VOXX (1)	313.9	-33	920.8	-23	1.0	-90	-4.7	NM	0.3	2.1	-0.6	NM	-0.08
AVNET AVT (6)	2201.2	-31	8196.2	-9	-19.2	NM	-183.4	NM	NM	2.6	-3.9	NM	-0.87
BELL MICROPRODUCTS BELM	489.1	-4	1480.3	18	-14.7	NM	-22.3	NM	NM	0.9	-14.5	NM	-1.07
CELLSTAR CLST (1)	610.5	-3	1828.5	3	-5.8	NM	1.9	NM	NM	NM	-6.7	NM	-0.24
GENUINE PARTS GPC	2099.2	-2	6273.1	-1	88.2	-4	272.2	-3	4.2	4.3	15.9	15	2.19
GRAINGER (W.W.) GWW	1199.4	-6	3643.8	-3	56.0	16	113.0	-22	4.7	3.8	10.3	26	1.70
HUTTIG BUILDING PRODUCTS HBP	256.7	-8	723.5	-14	2.3	-54	6.9	-51	0.9	1.8	8.5	15	0.33
PATTERSON DENTAL PDCO (8)	303.3	12	899.0	11	19.6	22	61.0	19	6.5	6.0	18.2	32	1.18
PIONEER-STANDARD ELECTRONICS PIOS (9)	589.1	-18	1909.3	-8	-4.7	NM	-2.9	NM	NM	1.6	3.0	27	0.33
PSS WORLD MEDICAL PSSI (9)	448.4	0	1342.7	-2	3.4	NM	-3.6	NM	0.8	NM	-11.9	NM	-0.47
RELIANCE STEEL & ALUMINUM RS	430.1	-3	1275.0	-3	7.8	-51	32.0	-34	1.8	3.6	7.9	14	1.70
TBC TBCC	278.9	4	761.6	17	6.0	13	15.4	8	2.2	2.0	10.8	12	0.93
UNITED STATIONERS USTR	950.9	-6	2989.6	1	-5.9	NM	37.5	-49	NM	2.6	12.0	15	1.85
WESCO INTERNATIONAL WCC	905.6	-7	2777.7	-4	5.1	-65	16.1	-56	0.6	1.5	9.5	20	0.28
(C) PRINTING & ADVERTISING													
GROUP COMPOSITE	3522.0	-2	10728.3	2	167.6	-21	474.5	-25	4.8	5.9	23.1	26	2.06
ADVO AD (3)	286.1	-4	839.7	-2	14.4	5	36.0	-2	5.0	4.6	NM	15	2.47
BANTA BN	376.6	-10	1086.8	-3	18.7	-3	33.9	-19	5.0	4.6	13.5	14	2.04
DONNELLEY (R.R.) DNY	1288.2	-10	3882.9	-7	42.0	-54	62.7	-68	3.3	6.4	12.6	23	1.11
OMNICOM GROUP OMC	1571.0	8	4918.9	13	92.4	8	341.9	-4	5.9	5.9	28.8	30	2.63
(D) OTHER SERVICES													
GROUP COMPOSITE	26046.2	3	76289.4	4	373.7	-57	2024.1	-11	1.4	3.4	10.2	22	0.76
ABM INDUSTRIES ABM (2)	492.5**	7	1453.4	9	13.2	6	33.7	13	2.7	2.7	13.3	14	1.94
AUTOTATION AN	5011.5	-6	14840.6	-7	79.2	-15	225.4	-11	1.6	1.7	7.8	12	0.88
CARMAX GROUP KMX (10)	851.4	26	2288.2	27	27.4	68	61.7	117	3.2	2.4	15.4	30	0.64
CASEY'S GENERAL STORES CASY (8)	579.8*	9	1480.6	7	12.7	-19	18.2	-35	2.2	3.0	9.1	20	0.65
COI CDI	358.8	-19	1151.4	-11	-2.0	NM	2.8	-92	NM	2.5	0.0	NM	0.01
CENDANT CD	2481.0	103	6370.0	83	210.0	-2	730.0	42	8.5	17.5	16.4	13	1.01
CINTAS CTAS (7)	564.6	8	1664.3	11	56.5	11	171.6	12	10.0	9.7	17.7	30	1.33
CONVERGYS CVG	567.2	2	1729.9	8	3.0	-94	82.4	-40	0.5	8.6	11.7	31	0.91
GROUP 1 AUTOMOTIVE GPI	1021.0	7	2956.5	8	15.9	37	39.3	21	1.6	1.2	17.2	12	2.31
HANDLEMAN HDL (8)	261.1	13	925.1	8	2.0	17	28.2	7	0.8	0.8	16.4	8	1.56
IMS HEALTH RX	328.1	8	992.0	-8	41.3	NM	171.7	130	12.6	NM	76.3	30	0.71
KELLY SERVICES KELYA	1066.4	-8	3219.8	-4	4.6	-82	15.8	-75	0.4	2.3	6.4	20	1.09
LABOR READY LRW	259.9	-8	702.7	-2	7.9	-3	7.7	3	3.0	2.9	8.3	15	0.24
LITHIA MOTORS LAD	471.3	6	1353.5	8	7.7	2	15.6	-16	1.6	1.7	11.6	11	1.55
MANPOWER MAN	2675.4	-5	7947.4	-2	37.1	-31	98.6	-16	1.4	1.9	19.1	14	1.98
MODIS PROFESSIONAL SERVICES MPS	368.9	19	1222.9	-11	1.1	99	11.1	-90	0.3	19.0	1.4	27	0.20

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 11-1	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
QUINTILES TRANSNATIONAL QTRN	407.1	-1	1215.9	-3	-265.9	NM	-248.4	NM	NM	1.1	-17.1	NM	-2.05
REGIS RGIS ⁽⁸⁾	349.7	13	1026.5	14	15.4	21	43.6	12	4.4	4.1	15.7	16	1.31
ROBERT HALF INTERNATIONAL RHI	574.7	-17	1942.4	-3	23.1	-52	108.4	-22	4.0	7.0	20.1	25	0.86
SERVICEMASTER SVM	1129.1	1	3153.5	1	35.5	-15	92.2	-26	3.1	3.7	11.9	27	0.42
SONIC AUTOMOTIVE SAH	1566.8	-2	4747.4	3	22.1	0	58.1	-6	1.4	1.4	14.9	10	1.70
SPHERION SFN	621.7	-34	2122.5	-25	-46.9	NM	113.5	48	NM	2.6	8.6	4	1.78
STAFF LEASING GVHR	798.5	2	2337.9	2	-14.5	NM	-14.3	NM	NM	0.1	-21.2	NM	-0.61
UNITED AUTO GROUP UAG	1595.8	20	4605.9	26	13.5	21	33.5	20	0.8	0.8	6.2	12	1.20
UNITED RENTALS URI	795.5	-7	2182.6	1	62.1	-18	90.4	-35	7.8	8.8	8.2	14	1.36
US ONCOLOGY USON	372.7	11	1119.2	16	12.9	11	33.5	-34	3.5	3.4	-13.6	NM	-0.92
VOLT INFORMATION SCIENCES VOL ⁽²⁾	475.7	-11	1537.4	-2	-1.2	NM	-0.2	NM	NM	1.8	3.5	19	0.61

22 TELECOMMUNICATIONS

INDUSTRY COMPOSITE	87321.1	-6	263789.1	-1	-6741.2	NM	-15902.3	NM	NM	9.8	-5.3	NM	-0.63
(A) EQUIPMENT & SERVICES													
GROUP COMPOSITE	45703.2	-6	139192.8	-1	-10754.7	NM	-23607.9	NM	NM	4.5	-12.7	NM	-1.60
ADC TELECOMMUNICATIONS ADCT ⁽²⁾	547.5	-39	2011.2	-11	-58.1	NM	-1110.8	NM	NM	1.1	-50.4	NM	-1.30
AT&T T	13087.0	-8	39964.0	-4	-2206.0	NM	-2740.0	NM	NM	9.3	-8.8	NM	-1.48
AT&T WIRELESS SERVICES AWE [†]	3502.0	25	10094.0	35	77.0	267	340.0	38	2.2	0.8	2.2	61	0.24
CENTURYTEL CTL	539.4	12	1574.3	19	92.3	37	293.3	68	17.1	13.9	15.7	13	2.46
Ciena CIEN ⁽²⁾	458.1	96	1235.5	116	5.7	-80	8.2	-85	1.2	12.1	0.9	NM	0.12
COMVERSE TECHNOLOGY CMVT ⁽¹¹⁾	345.1	18	1056.7	30	28.0	-46	183.8	15	8.1	17.7	15.0	15	1.36
CORNING GLW	1509.0**	21	5298.0	5	-22.0	NM	-4843.0	NM	NM	13.3	-81.5	NM	-5.30
LEVEL 3 COMMUNICATIONS LVL3	375.0	10	1213.0	61	-531.0	NM	-1797.0	NM	NM	NM	-75.2	NM	-6.36
LUCENT TECHNOLOGIES LU ⁽³⁾	5155.0	-28	16940.0	-22	-7329.0	NM	-12596.0	NM	NM	NM	NM	NM	-4.18
MCI GROUP MCIT	3484.0	-17	10654.0	-15	33.0	-91	66.0	-95	0.9	8.4	7.7	NA	NA
NEXTEL COMMUNICATIONS NXL	1992.0	30	5615.0	38	-619.0	NM	-1360.0	NM	NM	NM	NM	NM	-2.07
SCIENTIFIC-ATLANTA SFA ⁽⁶⁾	410.1	-31	1693.4	6	37.1	-67	186.7	-11	9.0	19.0	19.0	14	1.55
SPRINT (FON GROUP) FON	4244.0	-5	12912.0	-3	154.0	-60	760.0	-36	3.6	8.6	7.0	20	0.98
SPRINT PCS GROUP PCS	2651.0	55	6966.0	58	-288.0	NM	-928.0	NM	NM	NM	-93.8	NM	-1.48
TELEPHONE & DATA SYSTEMS TDS	675.0	11	1917.7	11	52.9	-21	-254.3	NM	7.8	11.1	-6.9	NM	-3.96
TELLABS TLAB	448.2	-45	1729.7	-22	-49.5	NM	-101.7	NM	NM	23.1	7.5	29	0.46
U.S. CELLULAR USM	501.0	11	1416.1	11	54.9	-42	147.8	-25	11.0	20.8	8.2	20	2.13
WILLIAMS COMMUNICATIONS GROUP WCG	297.8	42	855.2	55	-492.0	NM	-1039.9	NM	NM	NM	-65.7	NM	-2.30
WORLDCOM GROUP WCOM	5482.0	-6	16047.0	-5	503.0	-16	1177.0	-43	9.2	10.3	3.1	NA	NA

(B) TELEPHONE COMPANIES

GROUP COMPOSITE	41617.9	-5	124596.4	-1	4013.5	-42	7705.6	-62	9.6	15.7	9.1	33	1.14
ALLTEL AT	1899.0	2	5672.2	6	221.4	-54	816.2	-52	11.7	26.0	19.8	17	3.43
BELLSOUTH BLS	6013.0	-12	17917.0	-10	7.0	-99	1778.0	-43	0.1	15.1	16.1	25	1.53
BROADWING BRW	597.9	13	1784.2	20	-27.9	NM	-90.6	NM	NM	NM	-20.6	NM	-1.73
QWEST COMMUNICATIONS INTERNATIONAL Q	4766.0	0	15039.0	30	-142.0	NM	-3429.0	NM	NM	NM	-9.5	NM	-2.14
SBC COMMUNICATIONS SBC	11338.0	-16	34005.0	-13	2072.0	-31	6015.0	-10	18.3	22.3	23.4	18	2.14
VERIZON COMMUNICATIONS VZ [†]	17004.0	3	50179.0	5	1883.0	-29	2616.0	-71	11.1	16.0	12.4	32	1.60

23 TRANSPORTATION

INDUSTRY COMPOSITE	54599.4	-8	168389.8	-2	-957.0	NM	-180.9	NM	NM	4.7	0.8	NM	0.12
(A) AIRLINES													
GROUP COMPOSITE	21536.9	-15	68900.3	-5	-2431.4	NM	-4037.5	NM	NM	3.8	-18.9	NM	-3.03
ALASKA AIR GROUP ALK	583.4	-3	1678.7	2	25.3	59	-3.1	NM	4.3	2.6	-3.7	NM	-1.21
AMERICAN AIRLINES AAL	491.4	-17	1666.0	-6	-31.7	NM	-87.0	NM	NM	0.2	-22.1	NM	-3.83
AMR AMR	4816.0	-8	15159.0	2	-414.0	NM	-964.0	NM	NM	6.1	-14.7	NM	-6.00
CONTINENTAL AIRLINES CAL	2223.0	-15	7231.0	-3	3.0	-98	54.0	-82	0.1	5.2	7.8	11	1.66
DELTA AIR LINES DAL	3398.0	-22	11016.0	-13	-259.0	NM	-482.0	NM	NM	5.4	-10.3	NM	-3.88
NORTHWEST AIRLINES NWAC	2594.0	-17	7920.0	-7	19.0	-91	-207.0	NM	0.7	6.6	NM	NM	-3.31
SOUTHWEST AIRLINES LUV	1335.1	-10	4317.5	3	151.0	-18	447.6	-5	11.3	12.5	15.2	22	0.75
UAL UAL	4107.0	-16	13189.0	-9	-1159.0	NM	-1829.0	NM	NM	NM	-40.5	NM	-35.71
US AIRWAYS GROUP U	1989.0	-16	6723.0	-3	-766.0	NM	-967.0	NM	NM	NM	NM	NM	-15.93

(B) RAILROADS

GROUP COMPOSITE	8896.0	-1	26615.0	0	671.0	0	1726.0	1	7.5	7.5	7.5	17	1.76
BURLINGTON NORTHERN SANTA FE BNTF	2343.0	0	6907.0	1	225.0	-13	560.0	-23	9.6	11.1	10.5	13	2.07
CSX CSX	2019.0	-1	6101.0	-1	100.0	69	228.0	73	5.0	2.9	4.6	25	1.34
NORFOLK SOUTHERN NSC	1508.0	-2	4640.0	0	79.0	-20	247.0	48	5.2	6.5	4.2	26	0.65
UNION PACIFIC UNP	3026.0	-1	8967.0	0	267.0	4	691.0	1	8.8	8.4	9.2	16	3.34

(C) TRANSPORTATION SERVICES

GROUP COMPOSITE	11875.9	-4	35860.4	-1	197.4	-35	198.0	-81	1.7	2.5	-2.0	NM	-0.35
AIRBORNE ABF	772.8	-4	2408.5	-1	1.7	NM	-21.6	NM	0.2	NM	-4.0	NM	-0.69
BUDGET GROUP BD	610.2**	-13	1717.2	-10	48.2	329	-35.6	NM	7.9	1.6	NM	NM	-16.02
CNF CNF	1185.0	-16	3720.0	-10	-8.3	NM	-218.6	NM	NM	1.9	-22.3	NM	-3.90
DOLLAR THRIFTY AUTOMOTIVE GROUP DTG	299.6	-7	824.4	-2	6.0	-83	27.7	-62	2.0	11.1	7.0	9	1.37
FEDEX FDX ⁽⁷⁾	5037.0	5	14992.4	6	124.0	-27	345.9	-34	2.5	3.5	9.0	23	1.82

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 11-1	12 MONTH EARNING PER SHARE
	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 \$ MIL.	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL.	CHANGE FROM 2000 %	3QO QUARTER 2001 %	3QO QUARTER 2000 %			
GATX GMT I	363.9	5	1142.5	20	-7.3	NM	19.6	-82	NM	10.8	-6.2	NM	-1.18
HUB GROUP HUBG	323.0	-9	987.0	-4	-1.1	NM	-0.7	NM	NM	0.4	0.3	NM	0.09
PITTSBURGH PZB	884.3**	-8	2677.1	-6	9.2	-15	21.7	-28	1.0	1.1	-1.3	NM	-0.14
ROBINSON (C.H.) WORLDWIDE CHRW	784.5	5	2313.7	8	22.6	23	63.4	21	2.9	2.5	24.0	29	0.99
RYDER SYSTEM R	1242.8	-7	3818.4	-4	-5.5	NM	18.5	-70	NM	0.9	3.7	25	0.76
TRINITY INDUSTRIES TRN (9)	372.9	-32	1259.2	-27	7.9	NM	-22.2	NM	2.1	NM	-7.3	NM	-1.79
(D) TRUCKING & SHIPPING													
GROUP COMPOSITE	12290.6	-1	37014.2	1	606.0	-28	1932.5	-24	4.9	6.8	19.0	24	1.93
ALEXANDER & BALOWIN ALEX	264.1**	-8	834.1	3	17.3	-19	64.3	1	6.6	7.5	10.6	12	1.94
ARKANSAS BEST ABFS	381.6	-22	1188.7	-15	13.0	-44	31.9	-41	3.4	4.8	16.1	11	2.19
CONSOLIDATED FREIGHTWAYS CFWY	571.9	-4	1736.9	-2	-29.9	NM	-66.8	NM	NM	0.2	-39.4	NM	-3.32
HUNT (J.B.) TRANSPORT SERVICES JBHT	537.2	5	1554.1	-4	4.5	-50	14.8	-41	0.8	1.8	5.8	19	0.72
IRON MOUNTAIN IRM	291.7	14	868.9	21	-15.8	NM	-17.5	NM	NM	1.8	-1.5	NM	-0.24
LANOSTAR SYSTEM LSTR	355.7	1	1045.0	1	11.9	4	31.2	7	3.4	3.3	45.0	13	5.44
ROADWAY ROAD	631.7	-10	1924.3	-8	8.2	-25	17.2	-45	1.3	1.6	12.2	12	2.29
UNITED PARCEL SERVICE UPS	7481.0	2	22557.0	3	568.0	-19	1780.0	-19	7.6	9.5	25.2	23	2.19
USFREIGHTWAYS USFC	618.6	-4	1863.8	-2	9.7	-60	29.6	-60	1.6	3.8	7.9	16	1.98
WERNER ENTERPRISES WERN	322.6	6	950.0	5	12.5	1	34.0	-4	3.9	4.0	8.1	23	0.97
YELLOW YELL	834.6	-9	2491.4	-8	6.5	-67	13.9	-74	0.8	2.1	6.1	18	1.22
24 UTILITIES & ENERGY SERVICES													
INDUSTRY COMPOSITE	225305.5	28	676143.6	67	7705.1	-17	20632.7	0	3.4	5.3	10.0	17	1.71
(A) ELECTRIC, WATER & COGENERATION													
GROUP COMPOSITE	147054.2	26	425782.6	57	7415.2	-8	18075.6	7	5.0	6.9	10.3	17	1.84
AES AES I	2268.0	14	7028.0	29	3.0	-98	221.0	-62	0.1	8.2	7.8	16	0.87
ALLEGHENY ENERGY AYE	3682.0	248	8315.8	198	167.0	116	388.1	63	4.5	7.3	17.9	9	3.98
ALLETE ALE	411.5	31	1211.6	34	37.8	8	113.2	-13	9.2	11.2	11.7	13	1.77
ALLIANT ENERGY LNT	666.3	10	2130.8	25	64.0	-76	124.0	-62	9.6	43.3	10.5	13	2.27
AMEREN AEE	1431.6	20	3513.4	18	269.7	4	435.9	-1	18.8	21.7	13.5	12	3.30
AMERICAN ELECTRIC POWER AEP	18000.0	50	47000.0	81	420.8	17	918.7	88	2.3	3.0	9.1	20	2.17
AMERICAN WATER WORKS AWK	395.0	8	1075.3	6	55.8	10	128.6	5	14.1	13.9	9.7	24	1.68
AVISTA AVA	1403.8	-51	4991.6	-11	6.1	-83	64.2	114	0.4	1.3	16.1	4	2.74
BLACK HILLS BKH	302.4	-33	1283.1	24	16.4	0	83.3	149	5.4	3.6	20.7	7	4.13
CALPINE CPN	2909.2	294	5859.7	311	320.8	102	548.4	129	11.0	21.5	23.0	13	1.95
CINERGY CIN	3323.6	45	10672.2	89	129.3	36	334.3	7	3.9	4.1	14.6	12	2.64
CLECO CNL	307.0	14	863.8	46	31.1	-1	57.3	-5	10.1	11.6	13.4	14	1.38
CMS ENERGY CMS	2996.0	29	11472.0	104	-384.0	NM	-222.0	NM	NM	2.2	-14.8	NM	-3.16
CONNECTIV CIV	1669.0	9	4962.0	34	67.0	-34	381.8	113	4.0	6.6	31.9	5	4.49
CONSOLIDATED EDISON ED	2692.9	-5	7691.3	7	280.7	-1	567.3	4	10.4	10.0	11.0	14	2.83
CONSTELLATION ENERGY GROUP CEG	1036.1	7	3026.4	7	166.9	11	352.4	31	16.1	15.6	10.8	8	2.72
DOMINION RESOURCES D	2544.0	9	8051.0	25	344.0	32	661.0	114	13.5	11.1	10.7	20	3.09
OPL OPL	354.4	4	942.5	-6	85.8	61	183.0	54	24.2	15.6	41.6	9	2.71
OTE ENERGY DTE	2081.0	35	5713.0	37	63.0	-39	114.0	-65	3.0	6.7	5.4	24	1.73
DUKE ENERGY DUK	16718.0	7	48789.0	44	796.0	3	1769.0	19	4.8	4.9	16.8	15	2.66
EDISON INTERNATIONAL EIX	4043.5	11	9132.4	0	-407.2	NM	-1114.8	NM	NM	10.0	NM	NM	-11.30
ENERGY EAST EAS	798.8	23	2919.0	53	-20.6	NM	120.9	-34	NM	5.2	9.9	13	1.48
ENTERGY ETR	2575.7	-25	7723.4	5	317.5	4	723.9	10	12.3	8.9	10.3	11	3.39
EXELON EXC	4285.0	163	11759.0	169	403.0	73	1105.0	113	9.4	14.3	15.3	12	3.58
FIRSTENERGY FE	1951.6	3	5741.5	10	250.8	18	536.8	3	12.8	11.2	13.0	13	2.75
FPL GROUP FPL	2529.0	21	6636.0	27	337.0	6	673.0	4	13.3	15.2	12.7	13	4.31
GREAT PLAINS ENERGY GXP	492.6	30	1128.8	30	55.5	-32	88.8	-18	11.3	21.6	11.8	14	1.72
HAWAIIAN ELECTRIC INDUSTRIES HE	447.3	-1	1308.0	3	29.2	-8	84.0	-6	6.5	7.0	6.6	22	1.72
IOACORP IOA	395.5	26	1031.8	36	33.9	-18	104.8	-10	8.6	13.2	15.2	11	3.43
MIRANT MIR	8185.0	95	24295.0	354	234.0	157	533.0	96	2.9	2.2	13.1	14	1.75
NISOURCE NI	1756.4	49	7429.3	125	17.8	NM	163.8	7	NM	4.1	4.6	29	0.76
NORTHEAST UTILITIES NU	1723.9	9	5107.7	17	37.1	-46	223.5	37	2.2	4.3	12.7	9	1.93
NRG ENERGY NRG I	852.2	60	2137.7	60	141.6	60	225.9	60	16.6	16.6	13.1	13	1.38
NSTAR NST	890.7	26	2487.8	25	68.6	4	-25.9	NM	7.7	9.3	1.0	NM	0.24
OGE ENERGY OGE	827.8	-18	2639.2	14	97.1	-10	106.9	-24	11.7	10.6	11.2	15	1.46
ORION POWER HOLDINGS ORN	367.0	7	946.8	38	64.9	NM	101.3	473	17.7	1.1	7.4	23	1.11
PINNACLE WEST CAPITAL PNW	1574.0	-2	3806.7	33	162.5	40	291.6	12	10.3	7.2	14.0	11	3.93
POTOMAC ELECTRIC POWER POM	766.5	-7	1999.2	0	70.0	-42	184.4	2	9.1	14.6	18.7	7	3.06
PPL PPL	1438.0	2	4413.0	6	168.0	18	526.0	35	11.7	9.7	26.0	8	4.22
PROGRESS ENERGY PGN	2330.5	119	6554.3	131	366.4	23	632.1	29	15.7	27.9	10.0	14	3.05
PUBLIC SERVICE CO. OF NEW MEXICO PNM	621.9	25	2024.5	76	32.8	-30	145.9	68	5.3	9.4	15.8	6	4.01
PUBLIC SERVICE ENTERPRISE GROUP PEG	2401.0	9	7391.0	8	172.0	21	576.0	4	7.2	6.4	19.0	10	3.79
PUGET ENERGY PSO	619.7	-37	2675.0	24	6.8	64	113.3	9	1.1	1.9	12.1	9	2.01
RELIANT ENERGY REI	12467.0	31	37725.7	94	290.3	27	772.3	1	2.3	4.2	11.6	10	2.67
RELIANT RESOURCES RRI	10304.3	50	29856.4	133	133.1	-18	387.1	58	1.3	2.4	7.0	NA	NA
RGS ENERGY GROUP RGS	325.8	4	1182.0	17	3.5	75	59.4	17	1.1	4.5	10.2	17	2.28

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE- EARNINGS RATIO 11-1	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL	CHANGE FROM 2000 %	3RD QUARTER 2001 \$ MIL	CHANGE FROM 2000 %	9 MONTHS 2001 \$ MIL	CHANGE FROM 2000 %	3RD QUARTER 2001 %	3RD QUARTER 2000 %			
SCANA SCG	710.0	-13	2769.0	20	65.0	8	533.0	217	9.2	7.4	25.4	5	5.60
SOUTHERN SO	3165.0	-1	7996.0	3	554.0	6	1004.0	8	17.5	16.4	17.2	15	1.55
TECO ENERGY TE	678.8	10	1993.2	17	97.3	19	238.9	24	14.3	13.3	16.3	12	2.24
TXU TXU	6603.0	13	21105.0	39	344.0	2	759.0	-1	5.2	5.8	12.0	14	3.43
UIL HOLDINGS UIL	313.6	27	818.3	27	24.9	26	49.6	-9	7.9	8.0	11.6	12	3.97
UNISOURCE ENERGY UNS	429.7	26	1119.9	48	15.5	-10	47.6	69	3.6	5.0	15.7	9	1.80
WISCONSIN ENERGY WEC	822.0	-3	3036.2	36	47.9	7	171.3	37	5.8	5.2	9.7	13	1.69
WPS RESOURCES WPS	517.1	13	2091.7	70	22.6	66	59.4	6	4.4	3.0	11.5	14	2.56
XCEL ENERGY XEL	3652.5	22	10209.4	32	272.9	179	650.1	59	7.5	3.3	13.0	13	2.28

(B) GAS, OIL & ENERGY SERVICES

GROUP COMPOSITE	78251.4	30	250361.0	86	289.9	-77	2557.1	-32	0.4	2.1	8.5	21	1.26
DYNEGY DYN	8519.0	2	33499.0	72	286.0	22	569.0	44	3.4	2.8	16.4	17	2.00
EL PASO EPG	13845.0	3	45324.0	39	207.0	-27	-317.0	NM	1.5	2.1	-2.2	NM	-0.02
ENRON ENE	47613.0	59	139692.0	133	-618.0	NM	211.0	-77	NM	1.0	1.6	50	0.24
KEYSPAN KSE	1180.3	25	5230.1	63	-35.2	NM	183.1	-24	NM	1.5	8.0	19	1.72
MDU RESOURCES GROUP MDU	551.7	4	1739.3	37	50.7	27	126.9	70	9.2	7.5	15.1	10	2.44
OCEAN ENERGY OEI	279.0	4	1038.1	36	47.8	-17	255.2	74	17.1	21.6	22.1	10	1.82
ONEOK OKE	1117.9	-36	5445.9	38	18.8	86	109.4	11	1.7	0.6	9.2	13	1.36
SEMPRA ENERGY SRE	1627.0	-10	6944.0	46	103.0	-12	432.0	22	6.3	6.5	18.4	10	2.47
VECTREN VVC	358.4	13	1673.7	78	4.8	-70	35.7	-23	1.3	4.9	7.3	23	0.94
WILLIAMS WM8	2810.4	21	8719.0	33	221.3	25	939.1	56	7.9	7.6	20.3	12	2.51
WORLD FUEL SERVICES INT (9)	349.7	-8	1055.9	-4	3.6	NM	12.7	643	1.0	0.1	15.3	10	1.57

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

A	Ames Dept. Stores 8	Barr Laboratories 12b	Capital One Financial 17a	Computer Sciences 18c	Dollar Thrifty Automotive 23c	FedEx 23c
A&P 10c	Ametek 9a	Bausch & Lomb 12d	Cardinal Health 12a	Compuware 18c	Dollar Tree Stores 8	Fidelity National Finl. 17a
Abbott Laboratories 12b	Amgen 12b	Baxter International 12d	Caremark Rx 12a	Converse Tech. 22a	Dominion Resources 24a	Fifth Third Bancorp 3b
Abercrombie & Fitch 8	Amkor Technology 9d	BB&T 3c	Carlisle 15a	ConAgra Foods 10b	Donaldson 15c	First American 17a
ABM Industries 21d	AMR 23a	BEA Systems 18c	CarMax Group 21d	Concord EFS 17a	Donnelley (R.R.) 21c	First Data 18c
Acterna 9c	Anadarko Petroleum 11a	Bear Stearns 17a	Carnival 14d	Connectiv 24a	Dover 15c	First Tennessee Natl. 3c
ADC Telecomm. 22a	Analog Devices 9d	Beckman Coulter 9c	Casey's General Stores 21d	Conoco 11a	Dow Chemical 4	FirstEnergy 24a
Adobe Systems 18c	Andrew 9b	Bed Bath & Beyond 6b	Caterpillar 15c	Conoco 17b	Dow Jones 20b	Flsrev 18c
Advanced Micro 9d	Anheuser-Busch 6c	Bell Microproducts 21b	CBRL Group 14a	Consol Energy 11a	DPL 24a	FleetBoston Financial 3a
ADVO 21c	Anixter International 5	BellSouth 22b	CDI 21d	Consolidated Edison 24a	Dreyer's Grand Ice Cream 10b	Fleetwood Ent's. 14d
AES 24a	AnnTaylor Stores 8	Belo 20b	CDW Computer Centers 8	Cons. Freightways 23d	DST Systems 18c	Fleming 10a
Affiliated Computer Svcs. 18c	AOL Time Warner 18c	Bemis 7b	CellStar 21b	Constellation Brands 6c	DTE Energy 24a	Flowers Foods 10b
AFLAC 17b	Apache 11a	Benchmark Electronics 9d	Cendant 21d	Constellation Energy 24a	Duane Reade 12a	Flowsrve 15c
AGCO 15c	Apple Computer 18b	Berkley (W.R.) 17b	Centex 13b	Continental Airlines 23a	Duke Energy 24a	Fluor 21a
Agere Systems 9d	Applied Biosystems 9c	Best Buy 6b	CenturyTel 22a	Convergys 21d	Dun & Bradstreet 17a	FMC 15c
Agilent Technologies 9c	Applied Industrial Tech. 21b	Bethlehem Steel 16b	Ceridian 18c	Cooper Cameron 11b	DuPont 4	FMC Technologies 11b
Air Products & Chemicals 4	Applied Materials 15c	Beverly Enterprises 12c	Champion Enterprises 13b	Cooper Industries 9a	Dura Automotive Systems 2b	Footstar 8
Airborne 23c	Apria Healthcare Group 12c	Big Lots 8	Charming Shoppes 8	Cooper Tire & Rubber 2b	Dynege 24b	Fort Motor 2a
Airgas 21b	Arch Coal 11a	Biogen 12b	Charter One Financial 17c	Coors (Adolph) 6c		Forest Laboratories 12b
AK Steel Holding 16b	Archer Daniels 10b	Biomet 12d	Chiron 12b	Corn Products Intl. 10b		Fortune Brands 15a
Alaska Air Group 23a	Arkansas Best 23d	BJ's Wholesale Club 8	Chiquita Brands Intl 10b	Corning 22a		FPL Group 24a
Alberto-Culver 8	Arrow Electronics 21b	Black & Decker 15b	Church & Dwight 6d	Costco Wholesale 8	E*Trade Group 17a	Franklin Resources 17a
Albertson's 10c	Ashland 11a	Black Hills 24a	Ciena 22a	Countrywide Credit 17c	EarthLink 18c	Freeport-McMoran C&G 16c
Alcoa 16a	Associated Banc-Corp 3a	Block (H&R) 17a	Cigna 22a	Coventry Health Care 12c	Eastman Chemical 4	Fuller (H.B.) 4
Alcoxa & Baldwin 23d	Astoria Financial 17c	Blockbuster 14b	Cincinnati Financial 17b	Cox Communications 20a	Eastman Kodak 14d	Furniture Brands 6b
Allienergy Energy 24a	AT&T 22a	BMC Software 18c	CINergy 24a	Crane 15c	Eaton 2b	
Allienergy Tech. 5	AT&T Wireless 22a	Bob Evans Farms 14a	Cintas 21d	Crompton 4	EchoStar Communications 20a	
Allergan 12b	Atmel 9d	Boeing 1	Circuit City Group 6b	Crown Cork & Seal 7a	Ecolab 6d	Gannett 20b
Allete 24a	Audiovox 21b	Boise Cascade 19b	Cisco Systems 18c	CSK Auto 8	Edison International 24a	Gap 8
Alliant Energy 24a	Autoliv 2b	Borders Group 8	Citigroup 17a	CSX 23b	Edwards (A.G.) 17a	Gateway 18b
Alliant Techsystems 1	Automatic Data 18c	BorgWarner 2b	CKE Restaurants 14a	Cummins 15c	El Paso 24b	GATX 23c
Allstate 17b	AutoNation 21d	Boston Properties 13b	Clayton Homes 13b	CVS 12a	Electronic Data Systems 18c	GenCorp 2b
Alltel 22b	AutoZone 8	Boston Scientific 12d	Cleco 24a	Cytec Industries 4	EMC 18b	Genentech 12b
Amazon.com 8	Avaya 9b	Bowater 19b	Clorox 6d		Emcor Group 21a	General Cable 16c
AMC Entertainment 14b	Avery Dennison 15a	Boyd Gaming 14b	CMS Energy 24a		Energizer Holdings 15a	General Dynamics 1
Amerada Hess 11a	Avista 24a	Brinker International 14a	CNA Financial 17b		Energy East 24a	General Electric 5
Ameren 24a	Avnet 21b	Bristol-Myers Squibb 12b	CNF 23c		Engelhard 16c	General Mills 10b
America West Holdings 23a	AVX 9d	Broadwing 22b	Coca-Cola 6c		Enron 24b	General Motors 2a
American Axl & Mfg. 2b		Brown Shoe 6a	Coca-Cola Bottling 6c		Entergy 24a	Genuine Parts 21b
American Eagle Outfitters 8		Brown-Forman 6c	Coca-Cola Enterprises 6c		EOG Resources 11a	Georgia Gulf 4
American Electric 24a		Brunswick 14d	Cole National 8		Equifax 17a	Georgia-Pacific Group 19a
American Express 17a		Budget Group 23c	Colgate-Palmolive 6d		Estee Lauder 6d	Gillette 6d
American Greetings 14d		Building Materials 8	Columbia Sportswear 6a		Exelon 24a	Global Marine 11b
American Home 12b		Burlington Coat Factory 8	Comcast 20a		Express Scripts 12c	Golden State Bancorp 17c
American Intl. Group 17b		Burlington Northern Santa Fe 23b	Comerica 3b		Exxon Mobil 11a	Golden West 17c
American Mgmt. Systems 18c		Burlington Resources 11a	Commerce Group 17b			Goldman Sachs Group 17a
American National 17b			Commercial Metals 16b			Goodrich 1
American Power 9a			Community Health Sys. 12c			Goodyear Tire & Rubber 2c
American Standard 13a			Compaq Computer 18b			Goody's Family Clothing 8
American Water Works 24a			CompuCom Systems 18a			Grace (W.R.) 4
AmeriCredit 17a			Computer Associates 18c			Grainger (W.W.) 21b
						Graphic Packaging Intl. 7b

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FACE-



SCOTT McNEALY sees himself as the last challenger to **MICROSOFT's** bid for Web domination. Is his plan realistic? Or grandiose bluster?

BY PETER BURROWS

In this sorry economy, Scott G. McNealy says he thinks about quitting his job as chief executive of Sun Microsystems Inc. every single day. With a 2% stake in Sun that's worth \$668 million, McNealy would just as soon focus on playing hockey, perfecting his scratch golf game, or hanging out with his

Cover Story

three young sons and pregnant wife. Instead he's in the office, coping with the worst tech slump in 16 years. Sun has been losing money for the past two quarters and doesn't expect to see a profit until next summer. That has forced McNealy finally to give up his dream of avoiding layoffs. On Oct. 5, he became one of the last computer executives to hand out pink slips.

Why doesn't he just chuck it? He can't, he says, because now he has an even more crucial job ahead of him: Stopping archrival Microsoft Corp. from ruling the Web. "It really is mankind against Microsoft. And mankind needs a bit of a break

OFF

PHOTOGRAPHS BY (GATES) GEORGES DEKEERLEGETTY IMAGES; (MCNEALY) RICHARD MORGENSTEIN

right now," he says. His words are trademark McNealy—over the top, with a comic twist. And one can't help but wonder if this is just another theatrical moment in the longstanding feud between the two companies. McNealy insists it's not. He drops his usual patter to admit: "I know this sounds like ranting and raving." But he says he's in dead earnest. "This is why I don't quit this job. I've got more than enough money, but I don't want to leave my children to a Microsoft-only world."

Especially now. McNealy is incensed about the Nov. 2 announcement of a proposed antitrust settlement that he thinks barely raps Microsoft on the knuckles (page 112). "It's garbage," he says. "We've got a much more unfettered monopolist now—one that will hurt innovation and take away people's choice." Like many computer-industry execs, McNealy is dismayed by a settlement he says will do little to curb Microsoft's anti-competitive behavior. If approved by a federal judge, the agreement

will allow PC makers to fiddle with Microsoft's Windows software so they can prominently feature programs made by rivals. It will force Microsoft to share technology that lets outside programs, such as streaming media, work well with Windows. And Microsoft will have to disclose its Windows pricing so that it can't use it as a weapon against PC makers who install non-Microsoft products.

The problem is, those remedies are aimed at the PC realm, where Microsoft already dominates. The settlement does nothing to keep Microsoft from taking unfair advantage of its Windows monopoly in new markets by packaging Windows with services such as its Passport I.D. authentication, instant messaging, and videoconferencing. McNealy believes Microsoft is now free to use its monopoly unfairly to try to dominate the Internet as thoroughly as it does the PC market.

How does he plan to slow it down? By pushing Sun into overdrive to create technology for a new generation of Web services that will compete with those being rolled out by Microsoft. He doesn't have to beat Microsoft—just create a viable alternative. Until now, the Internet has been about Web sites that people beeline to for stock trades, plane tickets, filling out expense reports, and the like. In the next phase of the Net, these sites will communicate with one another to do a series of tasks on your behalf. If, for example, your flight is delayed, a service would let you know by pager while changing your online calendar and notifying your car service of a new pickup time. That might trigger another service to alert your next business appointment that you will be late.

CRUCIAL FACE-OFF. Web services are shaping up to be the next big frontier in computing. Technology leaders foresee a day when all manner of jobs, from managing relationships with customers to coordinating with distributors, will be handled by services delivered over the Net rather than with traditional software programs, phones, and faxes. While it's too early to tell how big the market will be, this is one topic where McNealy and Microsoft agree. "Everything in the world will be in Web services," says Microsoft Chairman William H. Gates III. If he's right, the companies building the underpinnings for these services could become the tech pow-

SUN VS. MICROSOFT

Sun Microsystems is facing off against Microsoft in a wide array of software and services.

Here's how the two archrivals stack up:

SERVER OPERATING SYSTEMS

Microsoft's Windows 2000 dominates the market for sub-\$100,000 servers used for lower-level jobs, such as doling out Web pages. But Windows runs less than 1% of the mid- and high-end servers that tackle big jobs. That's where Sun's Solaris system shines.

ADVANTAGE: SUN Microsoft will win lower-end markets, but the most critical computing will be done on high-end computers.

WEB SERVICES PLATFORM

Sun's ONE architecture pulls together software, including its Java programming language, to create a foundation for corporations to build Web services. Microsoft's .NET platform does the same thing, and is about a year ahead of Sun ONE.

ADVANTAGE: MICROSOFT Though as Sun ONE rolls out, it could gain ground because of the popularity of Java.

WEB SERVICES

Microsoft will offer a vast array of its own services. It already has a service that lets subscribers get traffic alerts wherever they are. Aside from basic offerings such as instant messaging, Sun won't offer services of its own—to avoid competing with its customers.

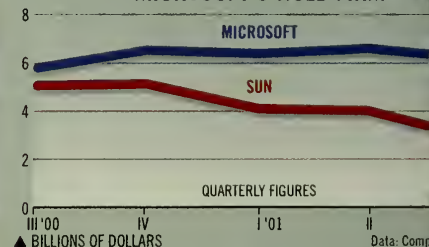
ADVANTAGE: MICROSOFT With Windows loaded on almost every PC, Microsoft will be able to market its services directly to about 140 million computer buyers next year.

Cover Story

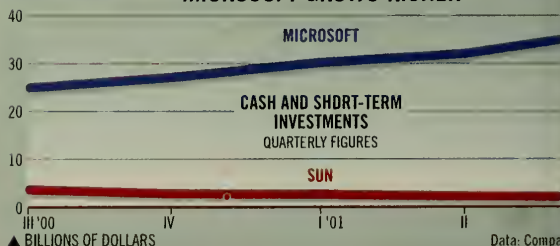
WHY SUN IS THE UNDERDOG

It grew faster than Microsoft in the dot-com heyday. Now it lags

SUN'S REVENUES HAVE FALLEN, MICROSOFT'S HOLD FIRM



SUN'S CASH DWINDLES, WHILE MICROSOFT GROWS RICHER



erhouses for years to come. And if Microsoft wins, it could maintain the kind of hold over the vast reaches of Internet computing that the company now has in the PC world.

That's why a face-off with Microsoft is so crucial for McNealy. "I'm the only one left," he says, who can put the technology pieces and partnerships together to offer an alternative to Microsoft. And, he says, he's the only computer executive standing who does not depend on Microsoft in some

RED ALERT Microsoft's unveiling of its .NET Web platform in June, 2001

puters—along with storage drives and other gear. The goal: giving Web-service providers everything that they need in one easy-to-use package.

McNealy will have to move fast if he hopes to keep pace with Microsoft. Once written off as a rich has-been from the PC era, the software giant has come storming back. Last year, blowing past Sun, Microsoft announced .NET, its platform for building Web services. And on Oct. 25, the company released a new version of its PC operating system, Windows XP, that is packed with online services, including Passport, which lets people avoid having to type in a password each time they visit participating Web sites.

While the antitrust settlement does little to slow Microsoft, McNealy says all the scrutiny of the software giant has had one favorable result for him. There's increased support from companies in media, travel, and other markets that share his concerns about Microsoft's Web plans. They fear that Passport and other services will allow Microsoft to collect reams of personal data on buyers and their habits that give it a leg up in offering yet more services. Those fears persist even though Microsoft has pledged not to track buying habits or market its own services to Passport subscribers.

Still, to combat the perceived threat, McNealy has taken the lead in establishing Project Liberty—an alternative to Passport. Project Liberty is a 34-company standards body that hopes to map out a blueprint so that any company's Passport-like services could hook up to any others. "My concern with Microsoft is that they're going to get between me and my customers," says a telecom executive who is one of Project Liberty's co-founders. "Microsoft has managed to piss off every one of us."

Will all this be enough to restore Sun to its former glory? Probably not. Sun's peak 60% revenue-growth rates are a

thing of the past. Because its high-end server technology is more popular with

corporations than Microsoft's, Sun should be able to hold or regain market share when the economy recovers. But server margins are tumbling because of increased competition from IBM at the high end and from Windows- and Linux-based servers at the low end. So, to boost profits, Sun will have to do well against Microsoft on its home turf—software.

Sun is in a better spot when it comes to Web services. Even though it's trailing Microsoft, its rival Sun ONE contains Java software, which is popular with corporations that have used it to create Internet programs. That means Sun should be able to gain ground once it has Sun ONE ready next year. The key question: Will Sun ONE be a strong enough alterna-

tive to prevent Microsoft from dominating the future of computing? If McNealy falls short, Sun could be well-liked by fate but increasingly irrelevant. And Microsoft could be stronger than ever.

That would be a devastating defeat for McNealy, who has deeply held beliefs about how companies should do business. His views were formed during his teenage years in suburban Detroit. That's when McNealy watched his father, a vice-chairman at American Motors, lose out to General Motors Corp. and Ford Motor Co. "If he sees someone go over the edge [ethically], it upsets him a lot more than it bothers most people,"

says his father, Bill. "I think it comes from being around an underdog as a kid and watching us struggle."

What upsets McNealy about Microsoft is how it has used its monopoly to beat software competitors such as browser maker Netscape Communications Corp. That, he believes, suppresses innovation by discouraging other tech companies from developing rival products. The losers, he says, are consumers and the economy.

Sun's philosophy is in stark contrast to Microsoft's. Sun created its Java programming language in 1995 so people could write Web applications that run on any computer. Sun shares management of Java with more than 200 companies that have licensed it. Even though some Java licensees have griped, Sun

doesn't control Java in the way Microsoft controls Windows. McNealy's strategy is for Java to fuel overall tech spending and for Sun to grab as much of that new business as possible.

Because of Sun's heritage, Web services should have been Sun's game. Since McNealy and three pals formed Sun in 1982, their philosophy was that computers that were networked together would be far more useful than stand-alone PCs. That's why every product in Sun's history has been based on the protocols at the heart of the Internet—the biggest network of all.

What went wrong? Sun became a victim of its own success. In the late 1990s, with sales racing, McNealy and his team had their hands full managing the business—no small feat given that the company's staff grew by 33%, or 10,000, in fiscal 2000. And with cash-flush corporations still pouring money into Java-based projects, Sun execs figured all was well. **HESSITATION.** Meanwhile, Microsoft saw an opportunity to last become a Net visionary—and executed perfectly. It grabbed the lead in advancing an industry standard called XML. A way of describing digitized data—whether they're specifications for a car part or the format of an insurance claim—XML is critical to Web services, since it lets data be passed among all kinds of computers and software programs. With Microsoft taking the lead, Sun hesitated and fell behind.

Microsoft's unveiling of .NET in June, 2000, was a wake-up call for Sun. While McNealy immediately dubbed the project "Not," many Sun insiders were impressed by how much meat there was on Microsoft's plan. They fumed at how .NET seemed to remake Microsoft's image overnight. It was su-



PAPADOPOULOS

Sun's chief tech officer pulled together a team to counter Microsoft's .NET plan

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corporations than Microsoft's, Sun should be able to hold or regain market share when the economy recovers. But server margins are tumbling because of increased competition from IBM at the high end and from Windows- and Linux-based servers at the low end. So, to boost profits, Sun will have to do well against Microsoft on its home turf—software.

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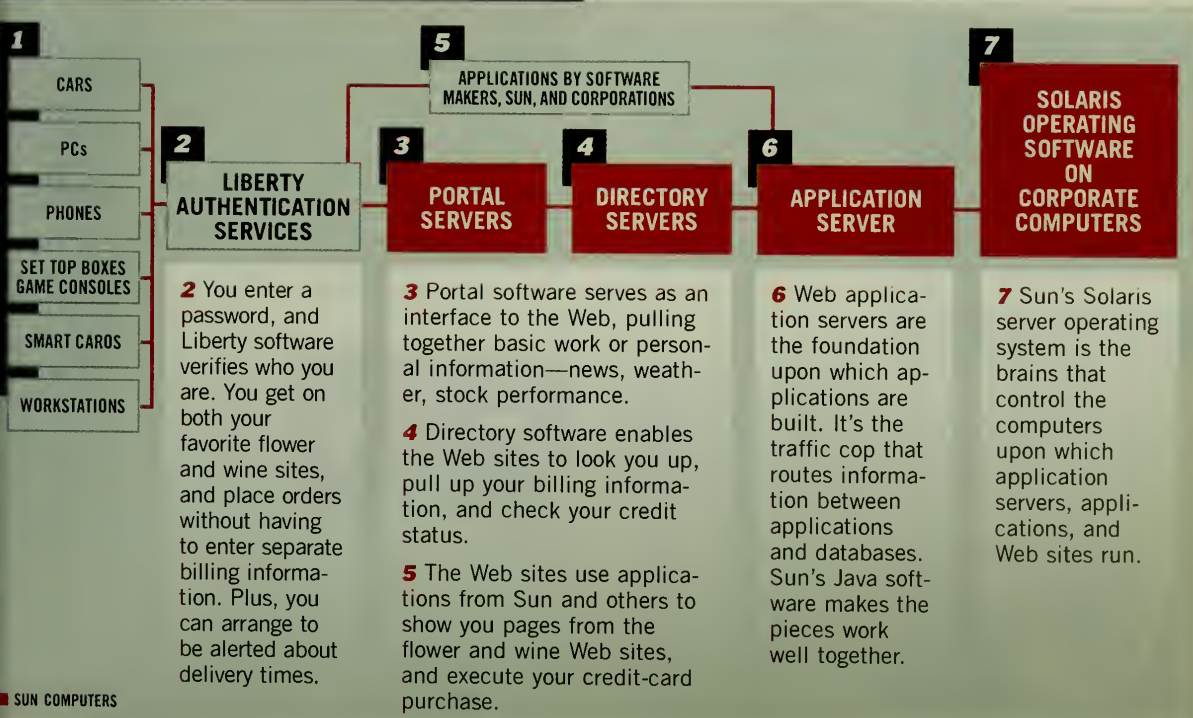
a wake-up call for Sun. Still, McNealy dubbed the project “.Not”

only the leading Web-services pioneer. Some Sun executives and Web developers might migrate to the .NET camp. Sun got moving, albeit slowly. A nine-person task force led by Chief Technology Officer Greg Papadopoulos began to pull together Sun's Web-services plan. But the company didn't fill out the details until last month. In mid-2002, Sun promises to release server software that will let corporate customers offer XML-based Web services to close partners. The technology to take that to the next level, to enable any of these Web services to work with those of any other company, won't be out until 2003. "Sun has not been a leader in Web services at all," says Gartner Group Inc. analyst David Smith. Microsoft is much more of the visionary than Sun." It's not just in terms of vision that Sun lags, but also in execution. Microsoft has delivered a steady beat of new products based on its .NET strategy. IBM also is ahead of Sun, say analysts. Already, 50,000 of its customers use its technology, called WebSphere, as a foundation for creating Internet applications such as programs that manage customer relationships. On May 14, it updated the software so it can be used as a basis for building Web services. McNealy denies Sun is behind Microsoft. Still, he's trying to make Sun think like a software company. On Oct. 5, it announced it was taking over AOL Time Warner's 50% stake in the iPlanet joint venture, maker of Web site and e-commerce

software. That will let Sun merge this group into the rest of the company. Rather than have a separate sales staff, Sun's 12,000 sales reps also will sell software on their rounds. Will the software push work? It's a long shot at best. While Sun is great at creating buzz for a new machine, "we just never have done a good job of marketing software," admits President Edward J. Zander. Consider application-server software, which dishes out applications for such tasks as managing a supply chain over the Web. Sun controlled 40% of the application-server software market in the mid-1990s. Since then, Sun's share has plunged to about 11% as IBM and BEA Systems have taken the lead. That smart—because these days many developers create Web programs that work on application servers rather than on operating systems, such as Sun's Solaris. "Sun is just way behind," says Scott Hebner, IBM's director of marketing for WebSphere. **TRUST FACTOR.** While Sun has a long way to go on the software front, interviews with corporate buyers and software developers suggest that, long term, Sun's technology is likely to be a viable alternative to Microsoft's Web services. Telekom Malaysia, for instance, uses Sun ONE technology for its iOffice Web portal for small businesses. It lets 40,000 customers store their phone lists online, make phone calls via the Net, and manage voice-mail, e-mail, and faxes—and have them delivered to their PC or read to them on the phone. Why did Telekom Malaysia not pick Microsoft? Mohamed Roslan Sallehuddin, head of the iOffice business, says "Microsoft was not even considered because their record of technology robustness and support in our company was bad." Sun's biggest advantage may be the trust factor it has engendered through years of backing open industry standards such as Java. Many software developers and corporate customers are confident Sun won't fiddle with Java to cut others out. In contrast, Microsoft critics say it takes advantage of owning Windows to beat other software developers. "Sun is

HOW SUN ONE SOFTWARE WORKS

Your anniversary is tomorrow, so you need to order flowers and wine fast. You tap into the Web from your home computer.



Sun's biggest advantage may be the trust it has built up by years of backing open industry standards such as Java

no Mother Teresa, but they have been in a position to take advantage of Java, and they haven't. Scott has to get credit for taking a different tack than Microsoft took," says David A. Litwack, CEO of SilverStream Software Inc. Microsoft's response: It makes it possible for scads of software companies to write programs to run on Windows.

Developers of sophisticated corporate software are firmly in the Java camp: It allows them to create programs quickly for

a wide variety of computers. A November survey by Evans Data Corp. showed that

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55% of developers plan to use Java to develop Web services in the next year, compared with 35% for .NET. That includes some close Microsoft allies: Software giant SAP will use Java in its corporate Web services—even though it does not plan on using other Sun ONE technology. "When we went to our customers, they said: 'Java is what we want,'" says Shai Agassi, CEO of the company's SAP Portals unit.

Of course, the success of Java means only that Sun gets to compete—it doesn't guarantee success. And McNealy has plenty of problems to deal with as he prepares for the coming Web-services face-off with Microsoft. One whopper: IBM. Big Blue has been selling its impressive new lineup of powerful servers at cut-rate prices to land big consulting gigs. While Sun's Unix market share declined from 38.9% to 35% between the second quarter of 2000 and this year's second quarter, IBM's lifted from 17% to 21.6%, according to IDC. Sun bounced back from a low of 31.6% in the first quarter, but, still, the price war has slashed Sun's gross margins on servers from 59% at the end of 1999 to 36% in the latest quarter.

Meanwhile, makers of PC servers such as Dell Computer Corp. continue to steal share in lower-end markets formerly dominated by Sun. Even though Windows servers have cap-

tured only 1% of the market for mid-tier and high-end servers, they have 60% of the market for low-end servers, according to IDC. While Sun's top-end Unix servers have more processing power and are considered more reliable, Windows servers have proved capable of handling demanding corporate computing tasks.

WRIGGLING OUT. Sun faces a dilemma. Unlike the PC maker it designs its own microprocessor and operating-system software. That bill comes to more than \$500 million a year. Those expenditures are essential, since they allow Sun to offer a more powerful alternative to Windows. But if Windows servers match Sun's capabilities and eat into Sun's market share, "they won't be able to maintain their margins and make the investments in software to keep up with us," says Microsoft .NET server software chief Paul Flessner.

As tough as times are for Sun, McNealy has shown that can wriggle out of tight spots. In the early 1990s, as makers were gobbling up share in the market for technical workstations that made up over 80% of Sun's sales, he spotted the opportunity to expand the server business and struggle with textbook efficiency.

Now, McNealy doesn't have to beat Microsoft: He just has to slow it down enough to keep it from dominating the Internet. While holding the high moral ground will doubtless help him in his quest, it won't determine who wins and who loses. That will depend on whether Sun's technologies deliver more bang for the bucks than do Microsoft's.

Contributing: Jay Greene in Seattle, Spencer E. Ante in New York, and Jim Kerstetter in San Mateo, Calif.

BusinessWeek online

A Q & A with McNealy can be found at www.businessweek.com

FIGHTING WORDS

Scott McNealy has never liked Microsoft much, but now his fervor is at an all-time high. Here's a history:

1982 McNealy co-founds Sun on the premise that networked computers that share files and processing power will be more useful than stand-alone PCs.



1993 Sun goes after Microsoft's Windows customers with software for PCs and technology that lets them run PC programs on Sun workstations. McNealy claims it will render Windows "frothing on a road apple," yet Sun makes almost no headway.

1995 After Microsoft scores big with Windows 95, Sun rallies the industry around its Java technology for Web applications. McNealy hypes "Java Stations" that will tap Web servers—minimizing the need for Windows PCs. His pet name for Windows: "Hairball."



1997 Microsoft tweaks Java to make it work better with Windows. Sun sues. When Microsoft calls on Sun to pass stewardship of Java to a standards body, McNealy says: "Having Microsoft give us advice on open standards is like W.C. Fields giving moral advice to the Mormon Tabernacle Choir."



1998 McNealy tells Congress that Microsoft's hold on software business is like "General Motors having the ability to decide what type of gasoline you put into your car."

2000 Sun is riding high on Internet sales, and Microsoft is facing a court-ordered breakup (*Judge Thomas Jackson*). Still, McNealy warns that Microsoft should be stopped from using the cash hoard from its "ill-gotten" monopoly to buy startups.

2001 The government drops its plans to break up Microsoft. McNealy's worries reach a new high. He says Microsoft's Web authentication service, Passport, will help it dominate the Net. He vows to offer an alternative. "It's mankind against Microsoft," he says.



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SETTLEMENT OR SELLOUT?

Justice's plan gives Microsoft lots of room to run over rivals

COMMENTARY By Mike France and Jay Greene

Trustbusters have a long history of letting Microsoft Corp. off the hook. The Federal Trade Commission started investigating the company in 1990 but dropped its inquiry after three years. The Justice Dept. took over in 1993 and pressured Microsoft Chairman William H. Gates III to sign a consent decree that was supposed to cut off his ability to prey on rivals—but in fact had little effect.

When trustbusters took on the company for a third time, in 1998, they vowed to make a difference. And for a while, it seemed as if they would. Justice won a powerful court decision against Microsoft

last year and then had the core of the case unanimously upheld by a conservative appeals court. For a moment, it seemed as if trustbusters would solve the technology industry's most important and vexing policy problem: figuring out a way to keep Microsoft from abusing the power it holds as the owner of the Windows PC operating system—a critical piece of the nation's information infrastructure.

That now seems like an illusion. Instead of a long-term solution to the Microsoft dilemma, we're seeing history repeat itself. Even a cursory analysis of the settlement signed by the Justice Dept. and nine state attorneys general reveals that it continues to leave the company with an unfair advantage over rivals in the software market—and in a position to squelch innovative startups. Despite the crowing of Justice's antitrust chief, Charles A. James, the settlement leaves the company free to repeat almost all of its old tricks. "This, along with AT&T, is one of the two most important cases of the postwar period," says Albert A. Foer, president of the independent American Antitrust Institute. "The settlement is a shocking disappointment."

Partly, that's because it solves the problems of the past in a fast-moving industry. If the deal goes through, Microsoft will be in a position to use its monopolies to expand into new businesses. Says Marc Be-

nihoff, chairman of Web software startup Salesforce.com Inc. "Fundamentally, what it means is the 800-pound gorilla is out of the cage." Just as the company has elbowed aside its competitors in PC applications and browsers, it could use Windows to go after everything from online music downloads to digital photo printing services to instant messaging. Netscape, Borland, and Lotus were targets in its past. No the likes of AOL Time Warner Inc. and streaming-media leader RealNetworks Inc. are in Microsoft's crosshairs.

QUANDARY. To be sure, the deal isn't final. It is still being posed by nine state attorneys general and a pack of competitors. U.S. District Judge Colleen Kollar-Kotelly plans to give the dissident states an airing early next year. According to a source in contact with the attorneys general, the nine states that are still suing may seek to force Microsoft to sell versions of Windows that don't include the code for certain types of software, such as instant messaging and media players. That would help level the playing field.

In fairness to James, it should also be said that there are no easy answers to the Microsoft quandary. At a time when the nation is at war and the economy is suffering, an argument can be made that the government shouldn't make life harder for the nation's leading software company. James has argued, and some independent experts agree, that the courts would not have supported a much stronger remedy.

And the proposed settlement does impose a few new restrictions on the company's conduct. "We think that it's a document that is very positive for consumers and the tech industry," says James (page 116). "It resolves quite successfully the issue that was the whole point of

DISSECTING THE DEAL

Critics say the Justice Dept.'s settlement proposal with Microsoft is riddled with loopholes and weaker than the deal the government sought last year—before a federal appeals court unanimously upheld the core charges against Microsoft. Here's a look at the proposal:

PROBLEM

DISCOUNTING

Microsoft rewards PC makers that favor its products by giving them a better price on Windows.

INTEROPERABILITY

Microsoft fails to give other companies the technical data they need to make their software run well with Microsoft's products.

BUNDLING

Microsoft wraps new products into Windows, so it's hard for rivals to distribute software.

SETTLEMENT PROPOSAL

The deal says Windows be sold with "uniform licensing agreements... terms and conditions."

It requires Microsoft to disclose more info about so-called APIs—the application programming interfaces that allow other types of software to run on Windows.

PC makers have the freedom to ship machines with Microsoft middleware and hide icons that activate Microsoft's products.

e Microsoft case—Microsoft throwing up roadblocks and impediments to the use of alternative [software].” Others agree. George Mason University antitrust professor Ernest Gellhorn says James is taking a reasonable position. The court of appeals “made clear that product integration is acceptable—even by a monopolist,” says Gellhorn. “What they held to be unlawful was exclusive dealing, retaliation, giving an advantage to their favored ones, manipulating prices, refusals to deal—and each one of those is dealt with in the settlement.”

LOOPHOLES. Under the terms of the proposal, Microsoft would have to give computer makers more power to choose software sold by other companies. Microsoft also would have to do a better job of sharing technical information about Windows with rivals at need to hook their products into the operating system.

That all sounds great, in theory. But a close look at the deal reveals that these requirements will be easy to evade (table). One provision would allow Compaq and Dell, for example, to hide access to Microsoft's Media Player and replace it with RealNetworks' competing product without fear of retaliation. But if the language of the settlement offers PC makers a taste of freedom, the economy of their business snatches it away again. Theirs is a low-margin business, where every extra dollar spent on hardware and software components can evaporate profits. They're not inclined to take on the expense of gathering software from a variety of companies and plugging it into their systems. Often enough, there are glitches with non-Microsoft software. The easiest course for them is to just take what Microsoft hands them.

Other provisions of the settlement are aimed at preventing Microsoft from retaliating against computer makers that don't favor Microsoft products. For instance, one key tool the company uses to control PC makers is the price of Windows. Because PC makers have thin margins, a small change in Windows pricing can make or break them.

The proposed settlement tries to nullify this tactic by forcing Microsoft to sell Windows with “uniform licensing agreements.” Yet the software giant is still fully free to punish PC makers that use rival products by charging them higher prices for the company's other software, such as the Office suite, critics

say. They also worry that it may also be able to evade the decree by entering sweetheart joint ventures with favored computer manufacturers. In fact, Microsoft won't have to alter its dealings with computer makers in big growth segments outside of PCs, such as handheld devices.

PC makers are reluctant to talk about the settlement. Publicly, they say they are pleased with the flexibility that this deal gives them. Privately, executives say they are deeply disappointed. “I didn't see any significant compromise on Microsoft's part,” says an executive at one major PC maker. “And I saw a lot of outs for Microsoft.” Indeed, he says the settlement doesn't allow PC makers to do anything they aren't already doing today. What the PC makers would like: the freedom to customize the way their products look and work to the liking of an individual customer. The way things are now, they have to constantly look over their

ESSENTIAL LOOPHOLES

Microsoft can still favor friendly computer manufacturers with lower prices on its other software, such as the Office productivity suite, critics say. They also are worried that it also has room to enter sweetheart joint ventures with makers.

API disclosures have to be made to manufacturers of “middleware,” a vaguely defined category of software that includes Web browsers and media players. Microsoft has no obligation to help manufacturers of handheld devices.

Financially strapped PC makers have little incentive to change the software that Microsoft offers with Windows. They would have to buy rival middleware at their own expense, increasing support and R&D expenses.

EARLIER PROPOSAL

During last year's mediation, Justice tried to put restrictions on joint ventures with PC makers and gave Microsoft less wiggle room for volume discounts and marketing subsidies. But other software products, such as Office, weren't covered.

Trustbusters tried to make Microsoft give up API information for manufacturers of handheld devices. They also supplied tougher legal standards for the speed and completeness of the disclosure.

Justice tried to force Microsoft to sell versions of Windows without some middleware in it, such as Web browsers. PC makers would have received a price break for stripped-down versions of Windows.

There's nothing in the settlement that prevents Microsoft from leveraging its monopoly into new Web services markets

shoulder to see if Microsoft will let them have a say about the PC user interface.

Along with computer makers, independent software manufacturers are supposed to be the second-biggest beneficiaries of the settlement. In fact, they're left practically defenseless. Software makers have long complained that Microsoft withholds critical technical information they need to allow their

products to run on Windows. For example, during the trial, Intuit Inc., which

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makes the Quicken family of personal-finance software, accused Microsoft of withholding information about the new version of Windows until the last minute to give Microsoft programmers a time-to-market advantage.

To fix this problem, trustbusters have installed a provision forcing Microsoft to disclose more information about its so-called application programming interfaces, or APIs. Those are the critical technical hooks

that enable software programs to run on top of the operating system. Yet the settlement only applies to so-called middleware, such as Web browsers—not to traditional applications such as Quicken.

WEB POWER. Perhaps more troubling, there's nothing in the settlement that stops Microsoft from leveraging its monopoly into new Web services markets. Microsoft's services include Passport, which allows people to sign on to a number of Web sites with one password, and Microsoft Wallet, which lets people fill in billing information once and shop on many e-commerce sites. Microsoft is free to include these services with Windows—just as it did with its Internet Explorer browser, the action that provoked the government to launch its anti-trust case. Meanwhile, rivals in Web services such as AOL Time Warner sometimes have to pay PC makers to include their services on their PCs. "The agreement fails to protect consumer choice and promote competition by leaving Microsoft free to continue to abuse its monopoly," says AOL General Counsel Paul T. Cappuccio.

AOL isn't in danger of being put out of business by Microsoft anytime soon, but upstart Web services companies are vulnerable. Take QPass Inc., a Seattle maker of software that authenticates visitors' identities on Web sites and provides e-commerce payment systems. Microsoft's ability to place Passport in a prominent position on Windows XP helps it gain customers, potentially setting itself up

to be the main authentication service on the Web. If that happens, "We would be gone in a puff of smoke that nobody noticed," says QPass CEO Chase Franklin, a former Microsoft employee. "This becomes an innovation choke point. It's just too much of a concentration of power."

WORRIED RIVALS. For its part, Microsoft executives insist the settlement is no sellout. Among other things, the company must submit to the rulings of a three-member technical committee that will oversee enforcement of the settlement.

The company and the government will get to choose one representative apiece, and they, in turn, will choose the third member. Based on the company's Redmond campus, the committee will have the power to hire staff at Microsoft's expense, as well as interview company employees and inspect their documents. If the committee believes Microsoft has violated the terms of the consent decree, it is supposed to issue a confidential report to the Justice Dept. and the attorneys general.

More broadly, Microsoft says it learned valuable lessons from the trial, a three-year ordeal in which many partners shied away from supporting the giant. "We will focus more on how our actions will affect other companies," says Gates. "Along with this settlement come new responsibilities—to communicate in new ways, to be even more open, and to offer new design flexibility." In fact, in the past few years, Microsoft has been a leader in adopting Internet standards—which provide a more level playing field for tech companies.

Microsoft's rivals still have a hard time believing the company chastened. Consider Opera Software, a small Norwegian company that has developed a browser that has a modest legion of users. On Oct. 25, Microsoft launched MSN 7, a facelift to its online service. The facelift blocked Opera users from accessing the MSN site, instead opening a Web page that encouraged users to download the latest version of Internet Explorer. Within a week, Microsoft bowed to pressure and opened MSN up to every browser, but Opera is still worried for its future. "Microsoft has put us on a blacklist," says Opera CEO Jon S. von Tetzchner. "We can't continue to send out press releases every time they put in a glitch." Unless the Justice Dept.'s deal is strengthened, he may have to get ready to do just that.

THE ROAD AHEAD

Judge Colleen Kollar-Kotelly will soon start Tunney Act proceedings to examine the adequacy of the proposed settlement. Simultaneously, she'll begin a remedy trial for those states that didn't think the deal was adequate. Here's what's coming:

LATE NOVEMBER Tunney Act proceedings begin with Justice's filing of competitive impact statement.

DEC. 7 States that haven't signed on to the deal submit alternative remedy proposal and witness list.

DEC. 12 Microsoft responds to this and names its witnesses for alternative remedy phase.

LATE JANUARY Deadline for critics to submit responses to Tunney competitive impact statement.

FEB. 1-22 Depositions are taken as part of the discovery process

MARCH Kollar-Kotelly begins remedy phase of Microsoft trial.

SUMMER Remedy expected, if case has not been settled.

2003 If case appealed, likely timing of D.C. Circuit ruling

Legal affairs Editor France follows the Microsoft antitrust case. Seattle Bureau Chief Greene covers Microsoft.



NUMBER OF PEOPLE
ON YOUR NETWORK

NUMBER OF PEOPLE
ON YOUR BACK



RETURN ON COMMUNICATIONS

Fact: The sales department has different needs than HR. Or manufacturing. Or customer service. And they all need to be on your network. But it's not enough to build a network just to run everyone's apps. You need one that'll do so without causing you massive headaches. And that will return your investment. Short and long term.

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CHARLES JAMES DEFENDS THE DEAL

Justice's antitrust chief answers critics of the Microsoft pact

Since striking a deal with Microsoft on Nov. 2, Justice Dept. antitrust chief Charles A. James has come under heavy fire. Critics say his settlement will do little to prevent the company from repeating its past efforts to extend its operating-system monopoly. James defends his handiwork and fires back at those who say he gave up too much. He spoke to *Legal Affairs* Correspondent Dan Carney on Nov. 6.

Why is this the right settlement?

Not only have we eliminated [Microsoft's attempts to block competition], we've improved the ability of independent software makers to develop products that are fully competitive with those of Microsoft.

Most people expected to see something in the decree ordering Microsoft to sell a stripped-down version of Windows. Why wasn't that included?

People who suggest that are not recognizing that the tying claim [that integrating products into a monopoly operating system is illegal] was eliminated from the case by the appeals court. That's a tying remedy. It would have been very odd for Microsoft to win the right to sell integrated products and then be ordered to sell dis-integrated products as well.

The settlement's remedy relies on computer makers to stim-

RESOLUTE

"I can tell you flat out there has never been any politics involved in our decision in this case"

ulate competition offering competing software programs. Is that sufficient? Microsoft will be obliged to sell computer makers a version of Windows prices and terms respective of the software they choose. And, more important, the desktop is now for sale. Space on the desktop is now a real estate market. As you can see, companies like AOL Time Warner and RealNetworks Inc. are in the process of purchasing this real estate from Microsoft.

Some people have raised the question of higher-ups inappropriately influencing the settlement.

The Attorney General was very supportive. We kept him fully apprised of every stage. We explained to him where our positions were. He encouraged us to move forward according to the judgment we were making. There was never an instance where the Attorney General instructed me, or even suggested to me, that I do something other than what I've done.

And the White House?

As we approached...decisions that we were going to make news, we made appropriate reports. No one has ever attempted to influence our decisions. I can tell you flat out there has never been any politics involved in our decision in this case.

What about the story of [Attorney General John] Ashcroft aide David Israelite [recused himself from the case because he raised money from Microsoft during the campaign]? It was reported that he contacted AOL to inquire if the company was behind the hiring of a new attorney to litigate on behalf of state attorneys general.

I've had no communications with Mr. Israelite. I've seen the story. But I haven't talked to him.

Is the career staff comfortable with the settlement?

I haven't taken a poll. What I can say is that the staff lawyers working on this case—the senior people—have been fully involved in these decisions. And there's never been an instance when they said: "Stop, Charles. Don't do this."

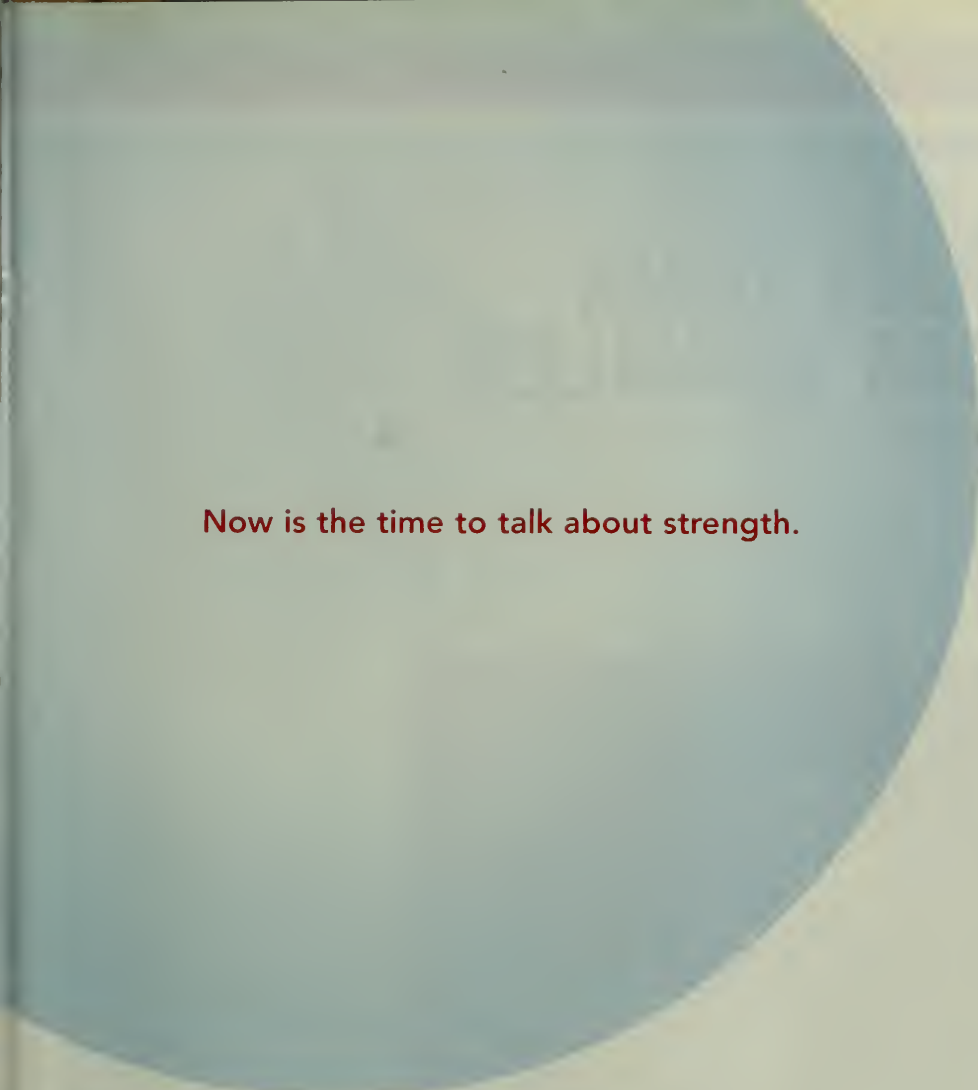
Why didn't you meet with any of Microsoft's rivals?

In this case I could have met with third parties 24 hours a day. What I did was make it clear that my staff was available to meet with third parties and that I was prepared to read anything a third party wanted to write. So I spent my weekends reading all of those advocacy pieces. Some were helpful, some were overreaching.

You've made a lot of Microsoft competitors very unhappy.

My goal in this process was not to get specific benefits for specific companies. We serve the public interest here. That's our only constituency. I had an interesting situation. Because I was so confident there was no relief everyone in the world was going to be satisfied with, I had complete freedom to do what I thought was right.

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Now is the time to talk about strength.



CNA

Times like these demand more than compassion. Which is why we'd like to provide some reassuring facts. We have over 100 years of experience, surplus in excess of \$8 billion and more than \$60 billion in assets. Policyholders, agents and brokers should feel confident in knowing that we will stand behind every single one of our commitments.

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EXECUTIVE COMPENSATION

THE GRAVY TRAIN JUST GOT DERAILED

Sorry, CEOs—"pay for performance" is back in vogue

During the go-go '90s, CEOs had it made. Thanks to a booming stock market and the magic of stock options, boards could shower top managers with rich pay packages without having to dig deep for more cash. It made for some astonishing paychecks.

Who can forget Charles B. Wang's \$655 million haul of restricted stock from Computer Associates International Inc. in 1999? Even after stocks began falling that year, many boards continued to pile on the dough. Some underperforming chiefs got raises. Others were

bailed out of underwater options with new grants or lower exercise prices on old ones.

Those days are gone. Thanks to the weak economy and the slumping stock market, the gravy train has been derailed. Directors are finally giving more than just lip service to the idea of pay for performance. In line with diminished corporate performance, bonuses are being scaled back or cut altogether. And some chief executives, including Thomas M. Siebel of Siebel Systems Inc. and John T. Chambers of Cisco Systems Inc., are taking voluntary pay cuts in a show of solidarity with beleaguered employees and shareholders. (Chambers, at least, didn't go away empty-handed. Three days after cutting his pay to \$1, the Cisco board gave him two million additional stock options—a healthy incentive to get the share price back up.)

With stocks down and bonuses a far memory, 2001 could deliver one of the biggest executive pay cuts in years, with CEOs likely to see double-digit declines. Ira T. Kay, national practice director for compensation consulting firm Watson Wyatt Worldwide, says total pay—including options exercises—for CEOs of the nation's 1,000 largest companies is likely to fall by a third, dipping below the \$1 million mark for the first time since the early '90s.

FEWER OPTIONS. It's easy to see why. Without the rocket fuel of a runaway stock market, executive pay is being forced into a lower orbit. According to *BusinessWeek's* annual survey of approximately 365 large U.S. companies, the average CEO earned \$13.1 million last year. Almost four-fifths of that pay came from option exercises. This year, fewer execs have had the chance to cash in. The number of big-company CEOs sitting on underwater-only options has nearly doubled since Jan. 1, 2000, according to Pearl Meyer & Partners Inc.

With board compensation committees meeting this month and next to decide 2001 bonuses and option grants, it will be a winter of discontent for many CEOs. Pay consultants who have met with those committees in recent weeks say boards that once rewarded underperforming CEOs to keep them from jumping ship are not inclined to do so this time. Shareholders are feeling too much pain for that kind of generosity. With many companies in dire financial straits and layoffs mounting, power has shifted to the board. Says pay consultant Alan Johnson: "This isn't the year you're going to go



KISS THAT PAY RAISE GOODBYE

Here's why 2001 promises to be a tough year for top executives:

STOCKS TANKED

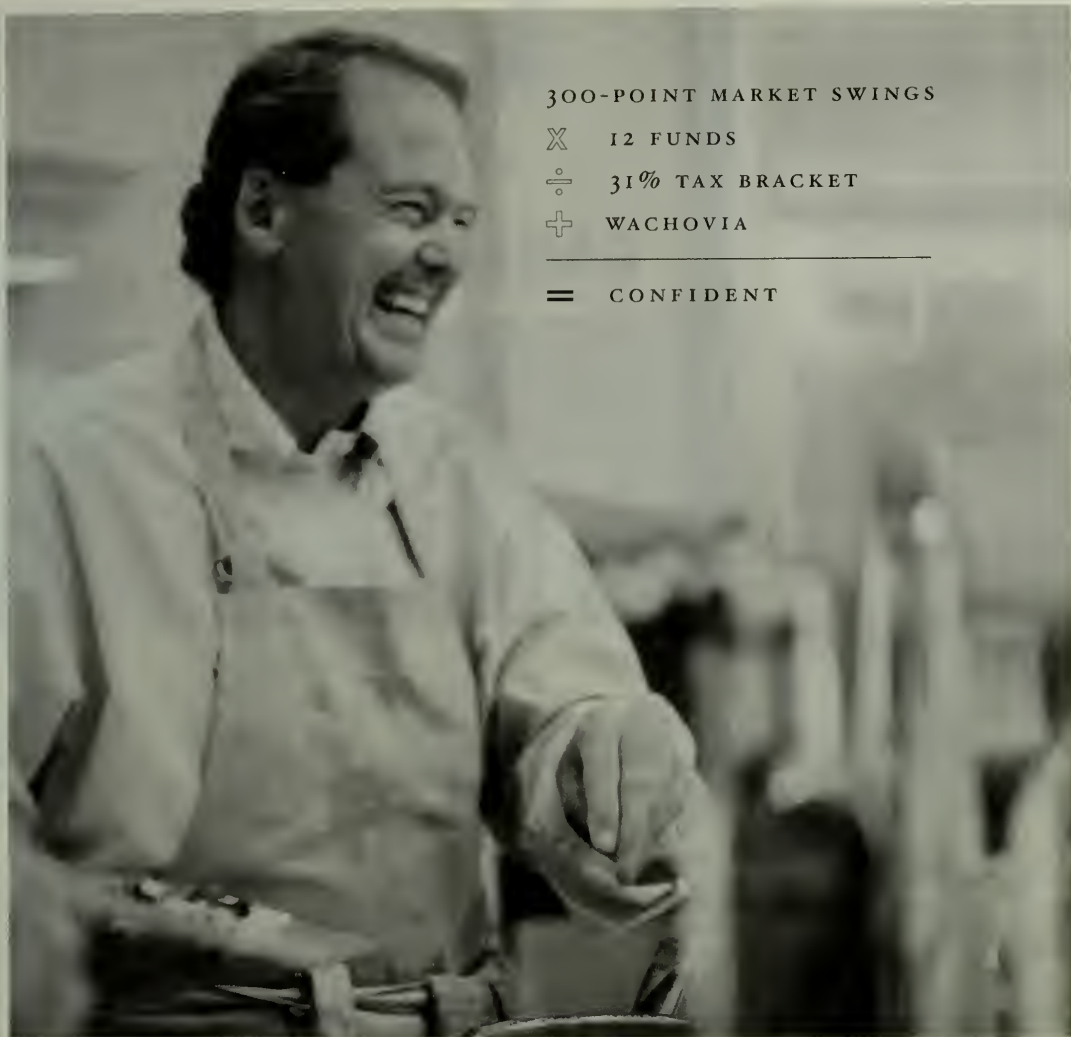
With stocks down sharply, lots of execs are sitting on underwater options. A quarter of the CEOs at 200 top companies, including Kenneth Lay at Enron and Donald Carty at AMR, could be left with no in-the-money options by yearend.

PROFITS CRASHED

With revenues and profits collapsing, fewer CEOs will qualify for bonuses. National Semiconductor, for instance, eliminated all bonuses for executives above the level of vice-president, including chief executive Brian Halla.

POWER SHIFTED

It's hard for most chief executives to point to stellar performance. Meanwhile, shareholders got whacked. That shifts the balance of power from CEOs to boards, giving them greater leverage in deciding pay packages.



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your board and say, 'Hey, I need some nourishment here.'"

To their credit, boards now appear to understand that "pay for performance" means both getting rich in times of plenty and being humbled when prospects head south. Indeed, many companies are taking a strict by-the-numbers approach. Sportswear manufacturer Russell Corp. expects to end the year with earnings of \$1.23 to \$1.33 per share, well below last year's \$1.90. CEO John F. Ward earned nearly \$1.3

A DECADE OF RICHES



▲ MILLIONS OF DOLLARS

Data: BusinessWeek

million in 2000, including a \$519,579 bonus. Losing his bonus would mean a 41% cut in pay. Says Herschel M. Bloom, a Russell compensation-committee member: "There are benchmarks that have to be met before bonuses are granted. If it does not appear we are going to meet the benchmarks, there will be no bonus."

SPREADING THE PAIN. At some companies, especially in transportation, media, and other industries crippled by the September 11 terrorist attacks, the question is whether to hold the boss accountable for an unavoidable economic disaster. As compensation committees meet to set salaries and goals for 2002, some may be inclined to lower the bar. An August survey of 101 large U.S. companies by William M. Mercer Cos. found 29% had already tweaked their bonus plans. The goal: to avoid punishing execs for events outside their control and to provide an incentive after conditions improve.

Other companies are just spreading the pain evenly. For example, National Semiconductor Corp. not only has eliminated 2001 bonuses for high-ranking execs but will also delay salary increases companywide in 2002. Compensation-committee member Modesto A. Maidique says the terrorist attacks have made the timing of a recovery even harder to forecast. "We were expecting a tough time, and September 11 made it tougher," he says. This year, everyone is going to share in the hard times.

By Louis Lavelle in New York

Environment



POLLUTION

DUMPING ON THE POOR?

A cement plant that stirred up a low-income area may be shut

In March, 2000, New Jersey Governor Christine Todd Whitman attended the ground-breaking ceremony for a \$50 million cement manufacturing plant in Camden. It was a momentous occasion—the first economic investment the troubled city had seen in decades. "Company officials had their pick of a number of sites along the East Coast, but they chose Camden," Whitman boasted at the dedication ceremony.

But not everyone in Camden welcomed the St. Lawrence Cement Group plant. The factory is at the center of a national battle over "environmental justice." The question: Are poor and ethnic communities saddled with more than their fair share of polluting facilities?

Yes, charges a local residents' group, South Camden Citizens in Action. The group filed a suit against New Jersey's Environmental Protection Dept. alleging environmental racism—and if it wins, the victory could bring new headaches for business. "This case is a road map for environmental justice advocates," says Luke W. Cole, director of the Cen-

ter on Race, Poverty & the Environment in San Francisco and a lawyer in the case. Companies retort that it's an example of environmental do-gooding run amok—and could end up hurting the very people it's trying to protect.

TOUGH JUDGE? The Camden group's win came in April. District Court Judge Stephen M. Orloffsky ruled that New Jersey's permitting process had discriminated against Camden residents concentrating a polluting industry in a minority area that already was "environmentally burdened"—even though the company easily met all environmental regs. Citing the 1964 Civil Rights Act, which restricts policies that unfairly affect minorities, the judge found that the neighborhood would be "irreparably harmed" by new particulate and ozone pollution from the cement plant and the thousands of trucks that would troop into the facility every year.

The case, however, is unfolding on unexplored legal ground. Judge Orloffsky's original decision was undercut by a Supreme Court ruling, which prompted him to shift to a different section of civil rights law to justify his decision. He issued an injunction blocking the plant from opening, but the injunction was vacated by the same Appeals Court that could rule on the Camden case by the end of this year. And the likely outcome? "It's hazardous to try to guess which way they'll go," says Sheila

**TODAY
CAMDEN...**
More environmental-justice cases are likely to follow

ster, a visiting professor of law at Fordham University in New York. If the citizens' group prevails, it will be the first major victory for the 15-year-old environmental justice movement. Originally, groups filed complaints with the U.S. Environmental Protection Agency, which under the Civil Rights Act must withhold funding to local environmental agencies in states or cities with unfair policies. But the EPA has acted on only one such complaint—ruling against the activists—in the past three decades. The hitman, now EPA chief, did appoint a task force to clear out the backlog. "We've already initiated several investigations," says task force head Gail Ginsberg. But activists are skeptical. "The EPA has been completely absent in terms of enforcement," charges Cole.

BURNING GROUND. That's why the activists have turned to the courts. The Camden case is the first big test of the new strategy. The effort started when concerned local residents banded together and contacted Cole's group and the Public Interest Law Center of Philadelphia. Working pro bono, the

ances to business, environmental justice activists are setting off alarms in boardrooms. With George W. Bush in the White House, industry thought it was relatively safe from "green" assaults. Now, companies are rushing to fight back. Business has assembled a blue-chip list of corporate lawyers from groups such as the National Association of Manufacturers (NAM), the American Chemistry Council, and the U.S. Chamber of Commerce to battle the Camden case.

Company execs argue that environmental justice actually hurts the people it is trying to help by denying them new jobs and economic investment. The movement, execs say, could undermine so-called empowerment zones, in which companies are given tax breaks to locate in blighted communities.

Indeed, Corporate America charges that a court ruling against St. Lawrence would have a chilling effect on investment in cities. Execs say they would have to take a wide range of demographics into account on every permit process or face the prospect of having a

court revoke the permit. "It creates tremendous uncertainty," says Keith McCoy, director of environmental quality at the NAM. "Companies will be hesitant to locate into these communities."

Certainly, St. Lawrence might have thought twice about putting its 15-employee plant in Camden. It fumes that a court ruling against it would amount to an unfair changing of the rules. After spending two years and millions of dollars on the permit process, it faces the threat of a shutdown. "This is a port district. It's zoned

BURNING ISSUE

St. Lawrence says residents are shutting out economic redevelopment

heavy industrial," says St. Lawrence attorney Brian Montag, a partner at Pitney, Hardin, Kipp & Szuch in Morristown, N.J. "We did everything you can possibly require."

If the activists have their way, the message will be widely broadcast that everything wasn't enough. Each side vows to appeal to the U.S. Supreme Court if it loses. Whatever the eventual ruling, the implications of the Camden case will ripple across the business landscape for years to come.

By Lorraine Woellert in Washington



lawyers helped the group charge New Jersey with violating local residents' civil rights. The grounds: The state allowed the cement mill to be built in an area that's 81% African American and 12% Latino—and where many residents already have health problems. With several manufacturing plants, two sewage treatment facilities, and an incinerator operating nearby, Camden had become an industrial dumping ground for the state, residents say.

Scoring victory in Camden, environmental groups are plotting bigger wins. On Nov. 1, representatives from the Natural Resources Defense Council, ACP, Earthjustice, and others gathered in Washington to map a strategy for taking the legal effort nationwide. They are preparing lawsuits in California, New York, and Michigan, and another in New Jersey.

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THE COVERAGE CRUNCH

Providers are spreading premium hikes far and wide. That could doom some small companies

Randolph L. Marten, who owns and operates 4,000 trailers and tractors in Mondovi, Wis., does most of his business far from New York and Washington. But in the wake of September 11, the chairman of Marten Transport Ltd. is being hit with a 100% insurance hike that will drive his bill for coverage up to 4% of his \$260 million sales and take a big bite out of profits next year. "Despite our company's impeccable safety record," fumes Marten, "my insurance rate is doubling."

Millions of businesses, from makers of farm gear to landlords of condos, are facing hefty increases in property and casualty insurance rates since the terrorist attacks. To recoup the \$10 billion or so in immediate claims from New York—and perhaps \$60 billion more over the long haul—insurers are planning to spread the burden as widely as they can. "Everything is being hammered at the same time," says Fritz Mutter, CEO of Golden Pacific Insurance Services Inc., an insurance broker in Pasadena, Calif., who says he has seen tenfold hikes for coverage such as umbrella policies for businesses

since the World Trade Center towers fell. Worse, insurers have stopped writing some types of policies altogether, such as those for apartment building owners who have several buildings close to each other. Initially, airports found their war and terrorism coverage canceled. A few insurers are offering it again, capped at \$50 million and costing 8¢ per passenger—\$6 million a year for a large airport.

The crisis, far worse than the industry's record \$15 billion payout on Hurricane Andrew, could be a big drag on the economy. Pretax earnings for companies in the Standard & Poor's 500-stock index could be slashed as much as 2.5% next year because of higher insurance costs, warns Prudential Securities Inc. That could mean an earnings shortfall of at least \$12 billion. With economic growth likely to be modest at best next year, companies will be hard-pressed to pass the costs on to their customers. Indeed, the extra expense could be the last straw for some small and midsize companies, for which insurance premiums make up a larger portion of sales. "It's like a huge additional tax with no returns, which could result in small companies going out of business," says Sung Won Sohn, chief economist at Wells Fargo & Co.

Already, the squeeze is making it tough for some businesses to raise financing. That's because their bankers fret that higher insur-



ance premiums will hurt borrowers, especially small businesses. "We now have to examine whether paying double premiums might affect a company's cash flows," says Gary M. Youmans, executive vice-president at Community National Bank, a small-business lender in Fallbrook, Calif. Real estate companies, especially, are suffering as they lose their terrorism insurance. Brookfield Properties Corp., a major real estate investment trust that owns buildings around the World Trade Center, shut the markets when it announced that its terrorism coverage had been withdrawn when it renewed. As a result, it may now be in technical default of loan conditions.

To ensure that coverage is available

STEEP INCREASES

How insurance bills will rise for basic business-liability coverage

Data: Insurance brokers polled by *BusinessWeek*



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Washington is creating a safety net for the industry. Legislation, expected to pass by Thanksgiving, would have the Federal government pick up, at least temporarily, 90% of the costs of future terrorist incidents if claims rise above a certain level—\$1 billion in a House bill, \$10 billion in a Senate version. Treasury Secretary Paul H. O'Neill has argued for such federal backstops," saying the risk of terrorism is impossible to calculate. Adds House Financial Services Committee Chairman Michael G. Oxley (R-Ohio): "This is not an insurance industry problem or a policyholder problem—it's a national economic problem that demands a national

AFTER THE FALL

Claims from the World Trade Center could reach \$60 billion over the long haul

solution. Affordable, available terrorism insurance is necessary for the economy to function effectively."

Insurers are nervous, too, because they don't know for sure that their reinsurers will make good on claims. U.S. regulators have opened an investigation into Lloyd's of London to determine whether it can pay the roughly \$8 billion in claims that it faces from the destruction of the World Trade Center. After claiming reinsurance, Lloyd's estimates it has around \$1.9 billion in net liabilities and resources of about \$27 billion. "We have a 300-year history of paying all valid claims, and nobody should doubt our ability and commitment to ensuring that U.S. policyholders are compensated swiftly and efficiently," says Lloyd's chairman Sax Riley.

NEW ENTRANTS. Even before the attacks, insurers had begun imposing stiff hikes. On average, companies were starting to pay about 18% more this year than last, after enjoying more than a decade of rock-bottom premiums, according to Alice Cornish, an analyst at Prudential Securities. She says commercial insurance premiums in 1999 were lower than

in 1984. Insurers started raising rates after stock market returns soured at the same time that they faced a sharp hike in asbestos claims starting last year and fierce losses from Tropical Storm Allison this past summer. Even before September 11, the industry was headed for a \$36 billion underwriting loss, Cornish estimates. Now, losses may nearly triple.

Paradoxically, insurers' long-run prospects have brightened. Lloyd's told its 2,850 members in a newsletter that they stand to make money from the higher premiums. There's an "historic opportunity," it says, as some premiums have already gone up 1,400%. In the U.S., Chubb Corp. has admitted that premiums will likely rise over 200% next year. Says CEO Dean R. O'Hare: "This business is back and is headed straight up."

The chance to reap rich rewards is attracting new entrants into the business. Goldman Sachs has teamed up with American International Group Inc. and Chubb to form a reinsurer based in Bermuda with \$1 billion of capital. Private equity firms Warburg Pincus and Hellman & Friedman have joined with RenaissanceRe and State Farm Insurance to form a similar company.

But new companies can't form fast enough to push down rates for millions of clients facing increases now. "New insurance companies and the amount of capital raised is relatively small compared to what was lost on September 11," says Robert P. Hartwig, economist at the Insurance Information Institute in New York. Insurers overall expect to raise some \$15 billion in the capital markets over the next six months.

If insurers push too hard to raise premiums, they could spur companies to look for new ways of getting coverage. One possibility is catastrophe bonds. Issued by companies, they bear interest, but the wrinkle is that bondholders lose their capital if specified disasters such as earthquakes or hurricanes occur. First introduced in 1996, they failed to take off then because regular insurance was so cheap. Other risk-management mechanisms, such as not-for-profit insurance pools operated by groups of companies or municipalities, might emerge, as they did in Florida after Hurricane Andrew.

Before such innovation can take root, though, stiff cost hikes and cuts in coverage are sure to unsettle the markets further. With some 70% of reinsurance renewals due on Jan. 1, there isn't enough time to nail down alternatives. "The capacity crunch has arrived with a vengeance," says Chubb CEO O'Hare. Managers such as Marten will be paying the price of September 11 for some time to come.

By Pallavi Gogoi in Chicago, with Mike McNamee in Washington

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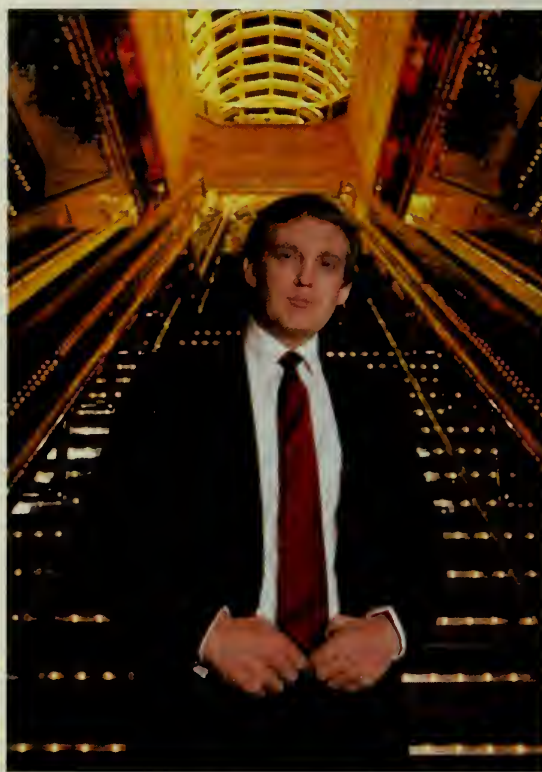
TRUMP ROLLS THE DICE WITH HIS CREDITORS

He's betting that they'll rework his debt to avoid a default

You'd think Donald Trump would have learned his lesson. In the early 1990s, the gambling and real estate czar nearly lost his empire after an acquisitions binge left his three New Jersey casinos in bankruptcy. After negotiating with creditors, he began to climb back, winning enough confidence from investors so that by 1995 he could sell \$130 million of stock in his Trump Plaza casino to the public. But then Trump got greedy again. Over the next year, his public company borrowed heavily to pick up his two privately held casinos at what many industry watchers considered rich prices. "I was offered a lot of money, and I took it," Trump says today. "You can quote me on that."

That borrowing has come back to haunt him. On Nov. 1, Trump says he deliberately missed two interest payments totaling \$90 million on Trump Hotels & Casino Resorts' \$1.8 billion debt. The company has seven bond issues with interest rates as high as 15.5%. Even though it has \$105 million in cash and over \$1 billion in annual revenues, according to Trump Hotels' most recent quarterly report, Trump is not paying. Instead, he is asking creditors to cut interest rates and extend maturities from as little as 2 years to 12. "With the right debt structure, this is a terrific company that will be poised for growth," says Trump.

LOST BUSINESS. Trump isn't the only casino operator with a weak hand. Many are struggling with a downturn in business, worsened by the terrorist attacks. Atlantic City casino revenues fell 6.5% in September. UBS Warburg analyst Robin M. Farley predicts that the gambling center could suffer its first revenue decline in 23 years. Making the situation worse, New York Governor George E. Pataki signed a law on Oct. 31 that allows casino gambling on Indian reservations in New York.



Trump, however, is the only one betting his creditors need him more than he needs them. If he's wrong, creditors could force his company into bankruptcy after a 30-day grace period ending on Nov. 30. Trump says he believes he can strike a deal and avoid bankruptcy court.

So far, creditors aren't budging. "He will default," says one bondholder, who asked not to be named. "It's just a question of when he wants to face the music."

Even before September 11, Trump Hotels was struggling to keep up with better-financed rivals such as Harrah's Entertainment Inc. and Park Place Entertainment Corp. They were

plowing millions of dollars into improvements such as fancy new slot machines. Meanwhile, Trump Hotels had trouble paying \$165 million in interest out of only \$207 million in pretax earnings in the first nine months of 2001.

Trump named a new chief executive this year to cut costs so that he could afford to give his franchise a face-lift. Mark A. Brown, a longtime Trump casino manager, centralized hotel operations, food and beverage services, and casino

marketing at Trump's three Atlantic City properties. He still cannot afford to pay for some services, though. "I've got slot machines at the [casinos] that don't have stools," Brown says. "Slots without stools do \$100 a day

SALAD DAYS

Trump in '87, in one of the Atlantic City casinos now threatened by better-financed rivals

with stools they do \$300

Despite his troubles, analysts and investors say, it's unlikely that Trump will lose control of his company. For one thing, vulture investors may be unwilling to get through the red tape involved in obtaining a license to run a casino in New Jersey. There's also a risk that an unwelcome investor could lose the casino brand name: Borgata

holders agreed that Trump can yield his moniker from the buildings if his ownership stake in the company sinks below 15%. He presently owns 42%.

Perhaps that's why, even though the company has problems, Trump still paid himself a \$1.5 million salary as chairman and \$2.3 million in consulting fees. On top of that, from 1998 to 2000, he charged Trump Hotels over \$4 million for letting high rollers use his condos in New York City's Trump Tower as well as his private 727 jet, according to a proxy statement filed in April. Trump concedes he may have to forgo some of that remuneration to strike a deal with bondholders. "Everything is up for discussion," he says. Everything, apparently, including how much he is willing to pay his creditors.

*By Christopher Palmieri
in New York*

LOSING BET

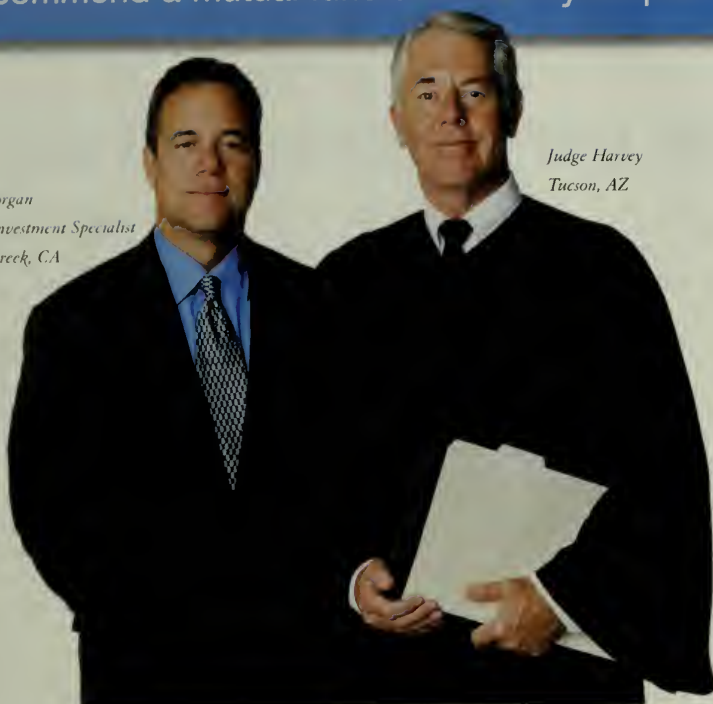


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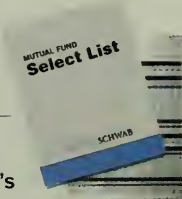
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COMMENTARY

By Timothy J. Mullaney

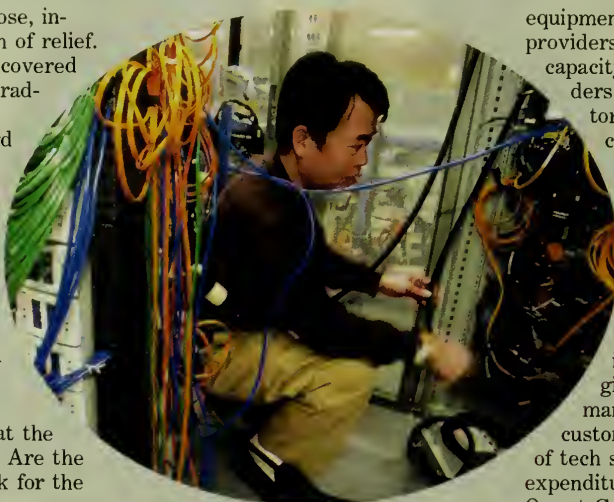
WHY TECH'S BOUNCE WILL FALL FLAT

As October came to a close, investors breathed a sigh of relief. Not only had stocks recovered from their nosedive when trading resumed following September 11, but the Standard & Poor's 500-stock index had posted a respectable 18% gain and continues to show strength. Even more astonishing, though, is that the battered tech sector led the charge. The 81 tech companies in the S&P roared to a 16% gain—after briefly topping the record 19.5% monthly rise posted in December, 1999, at the height of dot-com madness. Are the days of wine and roses back for the titans of tech?

Don't count on it. Sure, one could argue that tech stocks had nowhere to go but up after their 43% slide since the start of 2001. Interest-rate cuts by the Federal Reserve, on top of tax cuts, stimulate spending some. But the big turn in tech fortunes is a long way off—not until 2003 or 2004 by several analysts' estimates. Even Daniel J. Warmanhoven, CEO of data-storage equipment maker Network Appliance Inc., whose stock has jumped 144% since Oct. 1, can't help but rain on his own parade. "I don't see an upturn," he says.

HOLLOW OPTIMISM. The rally was sparked by a burst of optimism among individual investors. In October, they poured cash into equity mutual funds, much of it into tech funds. At Charles Schwab & Co., for example, September outflows of \$2.2 billion reversed to a \$506 million infusion by Oct. 26, according to S&P data. Talking heads initially predicted a surge in business for sectors such as data storage and computer security. But a raft of tech companies including Motorola, Intel, and Apple Computer are still giving low guidance for the fourth quarter and claiming 2002 is too murky to call. And Yahoo has cut its 2002 guidance, citing a weak on-line ad market.

True, bellwether companies such as Cisco Systems Inc. and Intel Corp.



STATIC DEMAND: A Network Appliance worker performs tests

have signaled that sales are no longer falling. But they've given little indication when buying might pick up significantly. Forrester Research analyst Bruce Temkin says technology sales likely will rise a paltry 2.2% next year from this year's depressed level—all of it in the second half—with double-digit growth not returning until 2004. That compares to juicy 20% sales growth in 2000. Says Lakshman Achuthan, managing director of the Economic Cycle Research Institute at Columbia University: "Until excess capacity is addressed, there's no rational reason corporations would say, 'Let's invest more.'"

During the heady go-go years,

UPWARD MOMENTUM?

Stock Performance (Sept. 28 to Nov. 7)

NETWORK APPLIANCE	144%
QLOGIC	147
BROADCOM	101
PMC-SIERRA	83
VERITAS SOFTWARE	93
S&P TECHNOLOGY	29.7
S&P 500	7.2

Data: Bloomberg Financial Services

equipment makers and service providers ignored the threat of overcapacity as they rushed to fill orders. In a healthy economy, factories run at 80% to 85% of capacity. Problem is that semiconductor factories now run at just 58% of capacity and telecom equipment makers at 64%, says Economy.com economist Wes Basel.

What's more, the situation could get worst before it gets better. Tech strategist Laura Conigliaro of Goldman Sachs & Co. says telecom customers, who account for 24% of tech spending, will slash capital expenditures at least 20% next year. Qwest Communications International Inc. is cutting capital expenditures 35%, to \$5.5 billion. Preoccupied with cost-cutting, financial companies—which account for another 19% of tech buying—aren't in the mood to boost outlays either.

If tech stocks were dirt cheap, their recent rise would make sense. But they aren't. Techs in the S&P 500 trade at 41 times next year's estimated earnings, double the index' average. Tech also remains much pricier than in past downturns. Steve Milunovich, chief tech strategist at Merrill Lynch & Co., says the current price-to-sales ratio of 4.5 is almost six times higher than tech's bottom in the '80s.

Meantime, analysts expect only a handful of tech stocks to post long-term earnings growth above 25%, even from this year's low base. And an established, diversified financial giant like Citigroup seems more likely to hit 15% growth than a tech upstart such as Yahoo! Inc. is to reach the 25% level analysts predict.

So what's the upshot? Conigliaro says tech stock indexes will stay put for up to a year. Milunovich says, "I'd sell into the rally." So investors who jumped the gun should enjoy their gains while they last.

Mullaney covers e-business from New York



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matters is the amount of time it takes to execute a given application."* We couldn't have said it any better ourselves.

Introducing the AMD Athlon™ XP processor. The processor that delivers extreme performance for Microsoft®

Windows™ XP. With its innovative QuantiSpeed architecture, the AMD Athlon XP processor boosts the performance of today's most

demanding applications.

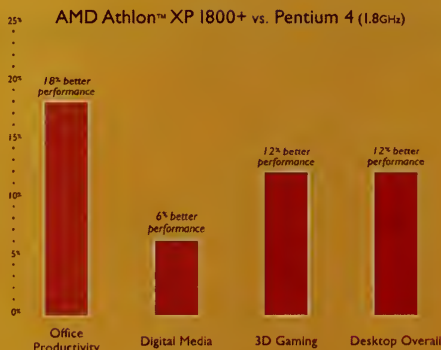
In benchmark tests, the AMD Athlon XP processor 1800+ outperformed a 1.8GHz Intel Pentium® 4 processor by up to 21%.*

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To see the full story and the suite of benchmark test results, visit www.amd.com.





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Taken from "Inside the Athlon™ 1800+ Processor" of the Intel® Pentium® Processor, revision 1.0, Intel Corporation 2000

Based on eTesting Labs Inc. Content Creation Workstone™ 2001, v1.0 benchmark comparing an AMD Athlon™ XP processor 1800+ with QuadSpeed architecture to a 3.8GHz Intel® Pentium® 4 processor. QuadSpeed was measured at 1.533GHz. See www.amd.com for system configuration information and specific benchmark results.

How to Keep Prying Eyes Off Your Medical Records

Will a new federal privacy regulation go far enough?

BY CAROL MARIE CROPPER

A North Carolina woman lost her job after her boss found out she had a costly, incurable genetic disease. In Illinois, anti-abortion activists somehow got the medical record of a woman hospitalized after an abortion and posted it on the Internet along with a photo of her leaving the abortion clinic. Meanwhile, angry CVS customers are suing the giant drugstore chain for sharing its prescription information with a marketing company.

These days, with medical records flying between computers and everyone from your company's benefits manager to irksome telemarketers fingering through your personal information, privacy has become a gnawing worry. Soon, with breakthroughs in DNA research, not just the diseases you have but also the ones your genes predict you will get could become part of that record. Last year, 61% of those surveyed in a Gallup poll said they were very concerned their information might be available to others without their consent.

And they should be. Until April, no federal law barred disclosure of an individual's health records. But a new federal privacy rule will make it illegal for health providers and insurers to improperly release patients' medical details without their consent (table, page 132). For example, any doctor or nurse who gossips about your medical care or shares the information with your boss will be subject to fines and a possible prison sentence. Health providers and insurance plans have until Apr. 14, 2003, to comply. Small plans have until Apr. 14, 2004.

The new law has its limits. It does nothing, for instance, to protect information gathered by life or disability insurance companies, or to curb

marketing companies that already have your personal data or can get it from nonprotected sources. However, advocates argue the new law is better than the hodgepodge of state laws widely varying (and often unenforceable) professional ethics that now protect your file.

Stories of abuse abound. Privacy consultant Larry Ponemon tells of the New Jersey doctor company he worked with a few years ago that used an outside call center to remind patients it was time to refill their psychiatric drug prescriptions. Curious call-center workers soon

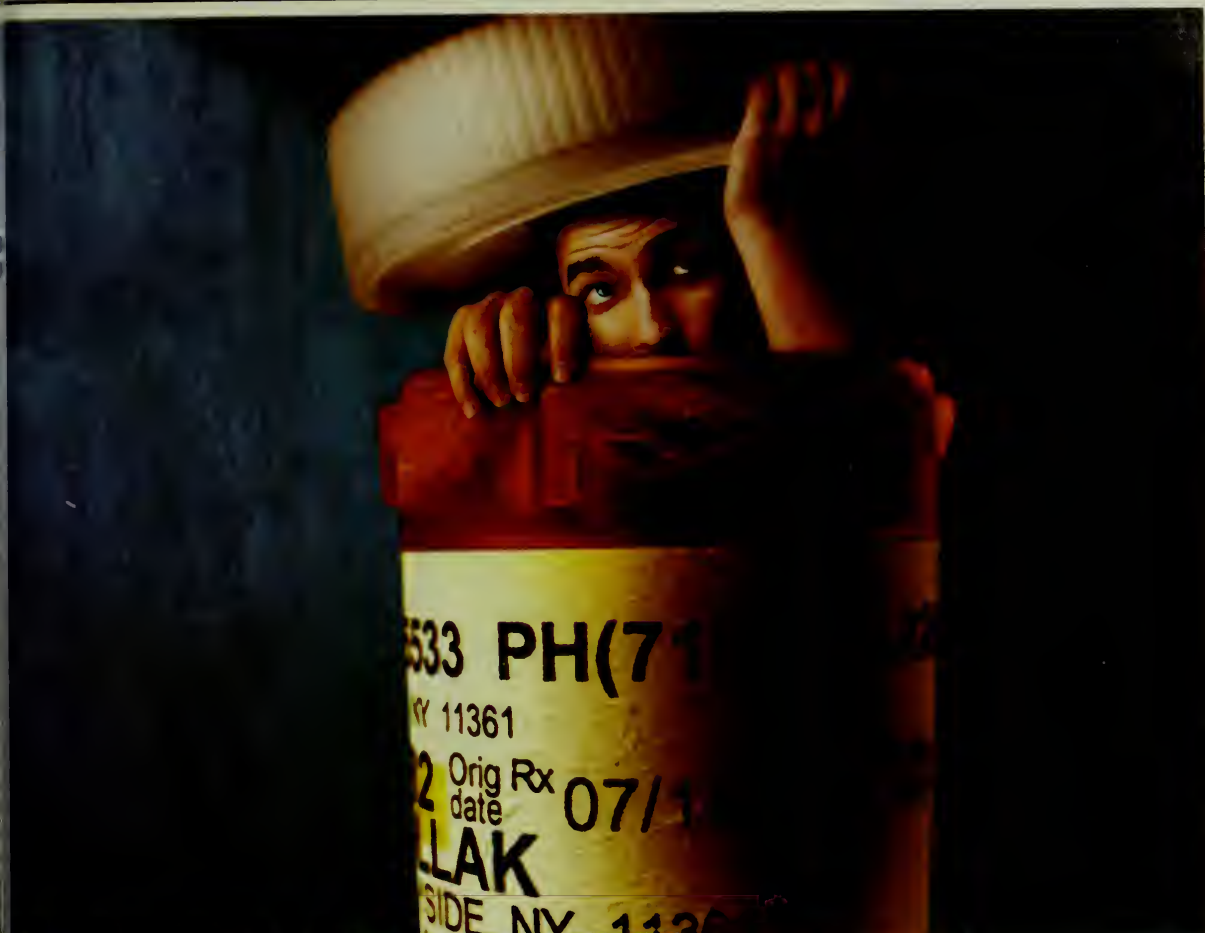
gleaned looking up lists of their hometowns, he says. Spotting people they knew, When word got back to the affected patient, she called in her lawyer. In another case, the Equal Employment Opportunity Commission last year sued the Burlington Northern and Santa Fe Railway to end its practice of secretly testing workers for genetic traits thought to be linked to carpal tunnel syndrome. The company was demanding a blood sample from employees filing work-compensation claims for carpal tunnel. Not until the wife, a nurse, did the real cause became clear.

LITTLE RECOURSE. Of course, laws forbid discrimination against someone in the workplace or in obtaining a consumer mortgage loan because of such things as disability, handicap, or pregnancy. But a victim must first find out the reason for the firing or loan denial. Then, he or she has to sue or file a complaint with the EEOC, Federal Trade Commission, or the U.S. Department of Housing and Urban Development—come up with proof to support the allegations. People simply embarrassed because, say, their small-town pharmacist gossiped about a Viagra prescription have even less recourse. Absent

Guarding Medical Secrets

- Don't tattle on yourself on marketing surveys, product registration cards, and forms for free health screenings.
- Think before registering on health Web sites or dialing toll-free numbers to ask about a new drug or an illness.
- Consider paying out-of-pocket for treatment when privacy is desired.
- Talk to your doctor and pharmacist about their privacy procedures.
- Edit the waivers on insurance forms so only information necessary to process your claim is released.
- Send in those "opt-out" forms from financial institutions (including insurers) that block information from being shared with third parties.

The risk that a bank will use health information from an affiliate to



the law, they could be limited to complaining to the offender's professional licensing board.

For most of us, having a current or prospective employer find out about an embarrassing expensive medical condition is the biggest worry. Large companies often self-insure, which means a health-plan administrator working down the hall from the boss may be reviewing employee claims for AIDS treatments and medications for depression. Terri Seargent of Wilmington, N.C., thinks that's how her boss found out about her genetic disease, alpha 1 antitrypsin deficiency, which causes a progressive loss of lung function and forces sufferers to take expensive drugs. Her small company's in-house health-plan administrator, who was also in charge of accounting, noticed the cost of her medication. Two months later, Seargent was forced to resign. She filed a complaint with the EEOC, which issued a ruling in her favor. The company says she was fired for poor performance.

Even companies that don't do the paperwork can find out what ails their workers. Sometimes, all an employer has to do is ask the insurer—which it pays—which employees are responsible for the leap in prescription drug use, says Robert Gellman, a privacy consultant in

Washington. Mary Henderson, an executive with Kaiser-Permanente, the large health maintenance organization, says her company refuses to give information that would identify specific patients. "But it has always been a difficult conversation," she adds. "They're our customers. No one likes to say no to their customers."

BEFORE THE FIREWALL. The new law will make it clear insurers have to do just that. It will also require employers that process claims in-house to maintain a firewall between the benefits office and the rest of the company.

Your **PRIVACY**

Until then, you can take some precautions on your own. You can pay your doctor for treatments out of your own pocket so there's no insurance claim report. You can then ask that details of certain ailments be omitted from your chart. To be extra safe, you could simply go to a doctor outside your managed-care plan. HMOs often demand access to participating physicians' files to evaluate their practices. Even when your insurer is paying, you can edit the authorization clause on your claim form to limit the information released to only that which is necessary to process the claim.

Despite fears of loose-lipped docs and cavalier insurers, patients themselves are probably the

most application is real, says Thomas McInerney of ING. "As a consumer, you won't know"

biggest source of leaks, says Beth Givens, director of the Privacy Rights Clearinghouse, a consumer group in San Diego. Companies such as Medical Marketing Service sell lists of consumers according to ailment—everything from Alzheimer's to yeast infections. Companies like Equifax and Experian—that's right, the credit agencies—gather the data.

Your PRIVACY

And they say they get it from you, through surveys mailed to consumers. For the

chance to win prizes or get coupons, millions of Americans provide their name, address—even phone number—along with a list of illnesses afflicting family members. Other marketing information is gleaned from forms filled out in return for free health screenings at malls. Even those little plastic cards shoppers use to get discounts at the grocery store can provide medical information if drugs or medications are purchased. Registering on a medical Web site, subscribing to a newsletter, or calling an 800 number equipped with number identification to ask about a drug can also land you on a marketer's list.

NEW DANGERS. Some disclosure is unavoidable. If you've ever applied for an individual life or disability insurance policy, you probably had to give the insurer authorization to obtain medical information. Even under the new privacy rules, insurers won't be restricted from sharing such records unless they are prohibited by state law or constrained because of a provision of the 1999 Gramm-Leach-Bliley Act that lets consumers opt out of some information sharing. Insurers routinely pool their data via MIB, a Boston-based company that serves as a central repository to cross-check information and look for fraud.

Meanwhile, passage of Gramm-Leach-Bliley,

which allows banks, brokerages, and insurers to consolidate, has created new dangers. Now, a mortgage company reviewing your loan application may be an affiliate of the life insurance company that knows you have cancer. Under the law, the merged financial institutions must allow customers to "opt out," or decide not to have their information shared with outside entities. But there's no provision allowing you to demand that information not be shared in-house. The risk that the bank will use health information from an application to reject a loan application is real, says Thor

McInerney, chief executive of the U.S. financial services arm of conglomerate Citicorp Group. "As a consumer, you would know. They'd just say, 'You don't meet our underwriting criteria.' (Remember, you can limit disclosure to outside companies by turning those confusing opt-out notices you've been getting from financial institutions. Only a small percentage of consumers has done so thus far.)

Once the new privacy regulation is in force, you will have the right to see your medical file, and health providers must show you their privacy policy. Many will do so now if you ask. But the new regulation may lead to less medical privacy in the areas of marketing and law enforcement. The regulation specifically allows doctors, hospitals, and health insurers to use patient information for marketing purposes—and even to collect money to do so. It also allows providers to contract with outside companies to handle mailings, as long as the material clearly states your doctor was the source. Patients can say "no," but only after they have already been marketed to once by each provider.

In another twist, the regulation makes it difficult for providers to give your records to police without a subpoena or court order. Before, says Gellin, the Washington privacy expert, no federal law covered these situations, but many would have considered such behavior as verboten and refrained.

In the end, the rule's biggest benefit may be to raise awareness—on all sides. In fact, Givens says one of the most important things you can do as a patient is make it clear to doctors and pharmacists how important discretion is to you. Find out how your medical information is handled and what privacy protections are in place. If your data is transmitted electronically, find out if it's encrypted. Last year, a hacker gained access to the records of 5,000 patients at the University of Washington Medical Center in Seattle, then leaked them to the media.

Become more careful yourself. Think before you give private information to someone other than a medical professional treating you. Understand the limitations on disclosure authorizations you sign. Opt out of financial information sharing. Learn what is protected under the laws of your state.

Remember, once a medical secret is out, you have no way to get it back.



The New Health Privacy Rule

On Apr. 14, 2003, federal law will finally protect your medical information. Here are some provisions:

- Health-care providers and insurers must have a written privacy policy—and give it to patients.
- Patients will be allowed to see and obtain copies of their own records and request changes.
- Those who illegally obtain or disclose health information will face a fine of up to \$250,000 and up to 10 years in prison.
- Employers that self-insure must maintain a firewall to prevent those processing employee health claims from sharing medical information with others at the company.
- Health-care providers and insurers must say when they're using patient information for marketing purposes. Patients have the right to nix future marketing from a source after an initial solicitation.

SHE SOUNDED SHORTER ON THE PHONE. 
 OOH, I HAVE A BAR — THAT'S THE SAME PERFUME — MOLLIE USED TO ON MY WRIST. 

..WHAT CAN I DO TO GET THIS GUY TO JOIN? 

NOW, THAT'S A PECULIAR LOOKING TATTOO. 

I HOPE I DON'T HAVE SOMETHING IN MY TEETH. I REMEMBER THE GOOD OLD DAYS WHEN "STOCK OPTIONS" MEANT SOMETHING.  

MY NEW SHAMPOO HAS STOPPED THE ITCHING, STOPPED THE FLAKES. 

DID HE JUST CALL ME "MA'AM"? 

WHY CAN'T EVERYONE BE AS FIRED UP AS OUR RECEPTIONIST, JEN? 

I DON'T UNDERSTAND WHY MORE PEOPLE DON'T USE PIE CHARTS. THEY'RE SO EASY. 

I SHOULD HAVE BEEN A TOLL BOOTH ATTENDANT. 

COULD THIS GUY HANDLE THE POLITICS? 

HERE? 

HERE? 

HERE? 

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ONLY 7 HOURS 53 MINUTES 'TIL I'M OUT OF HERE.  IN HINDSIGHT, I'M NOT SURE PRE-LAW WAS THE RIGHT MAJOR FOR ME.  DON'T BE FOOLED ONLY BY THE PHONE 7 HOURS 52 MINUTES 'TIL I'M OUT OF HERE.  I'M RUNNING THIS PLACE.  I SHOULD HAVE BEEN A CRUISE DIRECTOR. 

4 COMPANIES, 3 OFFERS (AND COUNTING). I'M IN THE CATBIRD SEAT NOW.

WHO CARES HOW MUCH FLEXIBILITY I HAVE WITH MY 401(K). I JUST WANT TO RETIRE IN 2 YEARS. 

THIS PLACE LOOKS NOTHING LIKE THE BROCHURE DESCRIBED. 

HOW MANY QUARTERS DID I PUT IN THE METER? 

PLEASE SAY 3 WEEKS OF VACATION. 

PLEASE SAY 2 WEEKS OF VACATION. 

PLEASE SAY... 

PLEASE SAY... 

PLEASE SAY... 

PLEASE SAY... 

PLEASE SAY... 

PLEASE SAY... 

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PLEASE SAY... 

PLEASE SAY... 

GOOD HAND- SHAKE. 

I WONDER WHO'S REALLY IN CHARGE. 

I HATE SMALL TALK. 

I DON'T UNDERSTAND WHY MORE PEOPLE DON'T USE PIE CHARTS. 

THEY'RE SO EASY. 

I SHOULD HAVE BEEN A TOLL BOOTH ATTENDANT. 

COULD THIS GUY HANDLE THE POLITICS? 

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People issues are complex. Managing them doesn't have to be. **Hewitt**

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Don't Let Crooks Steal Your Identity

How to protect yourself—and your credit rating

BY LARRY ARMSTRONG

Identity theft, the fastest-growing financial crime, has acquired a darker edge lately. One of the first things the FBI discovered about the September 11 hijackers was that as many as a half-dozen were using credit cards and drivers' licenses with identities lifted from stolen or forged passports.

In the weeks since, Americans have also suffered some erosions of privacy protection. While a dozen or so consumer-protection bills in Congress have moved to the back burner, new laws have given financial institutions more snooping rights, a move aimed at spotting transactions that might be funding terrorist activity.

You may not be able to deter the government's newfound interest in your personal business. But if you care at all about the privacy of your financial information—your credit history, your portfolio, your charge-card numbers—you

can protect yourself from criminals determined to exploit that information.

The theft can be as simple as someone pinning your credit-card number and charging merchandise to your account. Or it can be as elaborate as a crook using your name, birth date, Social Security number to take over your credit card and bank accounts, or set up new ones.

If your identity has been snatched, you're likely to learn about it when checks start bouncing or a collection agency begins calling. The damage isn't so much in dollars, since the financial institutions are liable for the unauthorized charges. Rather, the fallout includes a check of your credit history, which could prevent you from getting a mortgage or a job, and the countless phone calls and piles of paperwork you'll need to go through to set the record straight.

Guarding against identity theft is much like locking the door and activating the burglar alarm when you leave your home. By and large, identity crime is a low-tech operation, despite well-publicized instances of hackers breaking into a computer site and stealing millions of credit-card numbers. Usually, someone fishes a bank statement or credit-card offer out of your trash, or a dishonest employee peeks at your personnel file.

Your PRIVACY

A good tool for combating identity theft is a paper shredder. The crooks is a paper shredder. Park it someplace convenient, such as under your desk, and shred every piece of data-laden junk mail you get. Destroy records you don't need for tax or warranty purposes: bank statements, credit-card receipts, health-insurance claim reimbursements. And remember, because a



In the shadow of tragedy, our pride in America shines brighter than ever.

Yellow extends our heartfelt condolences to all the victims and families affected by the attacks on America. Yellow is proud to play a small part in helping to move America forward by continuing our mission of making global commerce work in a safe and secure manner.



Supreme Court decision held that trash left at the curb for pickup is in the public domain, you have no legal recourse against dumpster divers.

You can buy a perfectly good shredder for as little as \$10, such as Tech Solutions' TS-1600. Perched atop a wastebasket, it cuts paper into quarter-inch strips. For a few more dollars, you can buy a shredder with a built-in wastebasket, or one that shreds paper into finer, fettuccine-size strips. Spend \$100 or more, and you can turn your personal data into confetti. Most shredders can handle at least five sheets of paper at a time. If you're afraid someone will try to piece the strips back together, douse them in water before you put

them in the recycle bin.

You can't shred what you don't receive, so if mail theft is a problem in your neighborhood, consider installing a lockable mailbox. The least expensive models cost around \$150; according to new postal regulations, lockable boxes must now have a 1½-inch deep slot. But a hand can still slip into such a space, so most manufacturers use a baffle arrangement inside that lets mail drop to the bottom of the box yet stymies prying fingers. It's best to take outgoing mail to the post office, especially if it contains checks or important documents, rather than leaving it outside your front door for pickup. The blue, official mail-pickup boxes may be safer, but they, too, have been ransacked occasionally—particularly those in remote locations.

ANNUAL CHECKUP. Beyond guarding against people stealing documents, you should request a report from the three big credit bureaus at least once a year. A report from Equifax, Experian, or Trans Union costs about \$8.50, and you can order it online or by phone. Colorado, Georgia, Maryland, Massachusetts, New Jersey, and Vermont require the companies to give you an annual copy without charge if you request one, and you can always get a free report if you're a victim of fraud or an unsuccessful applicant for a loan or credit card.

Better yet, sign up for a credit-monitoring service. At \$40 a year, CreditWatch from Equifax is a bargain. The company scans your credit report every night and sends you an e-mail alerting you to any activity, such as a new credit card issued in your name or a credit check by a car dealership. The price includes six full credit reports a year.

Experian and Trans Union offer similar but more elaborate services, as do several independent companies, at prices ranging from \$70 to \$100 a year. If you rely a lot on credit, some of these services can be valuable. Take the credit score, a three-digit number that allows lenders to make an instant decision about your credit-worthiness. With the Experian's Credit Manager or Trans Union's Identity Guard, you can play "what if" by plugging in new data to see if your credit score changes: Can you qualify for a new mortgage, for instance, if you pay off your car loan immediately?

Your PRIVACY

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To stop pre-approved credit card offers:
888 567-8688

To get off junk-mail and telemarketing lists:
www.thedma.org/consumers/privacy.html

Thwarting Identity Thieves

MONITOR YOUR CREDIT Buy a credit report at least once a year. Subscribe to services that report credit activity back to you daily or weekly. Call your creditors if bills or replacement cards don't arrive on time.

WINNOW YOUR WALLET Don't carry rarely used credit cards or extra IDs. Don't use as your passwords and PINs any numbers, such as a birthday, that someone can find in your wallet.

GUARD YOUR MAIL If you suspect mail theft, get a lockable mailbox or rent a Post Office box. Mail envelopes with checks, credit-card numbers, or ID information at the Post Office.

TAKE IT WITH YOU Don't leave ATM receipts on bank counters. Don't throw credit-card receipts from stores or gas pumps in public trash receptacles.

SHRED, SHRED, SHRED Buy a shredder so personal information doesn't go out with the trash. Shred receipts, credit applications, canceled checks, and bank statements.

Read the fine print before signing up, though. Some credit services, especially those offered inserts with a credit-card bill, can be expensive. Others monitor credit reports only infrequently, such as once a quarter.

Trans Union's Identity Guard also covers up to \$2,500 in expenses, such as phone calls and for the time off work it takes to straighten up your affairs should you become a victim of identity theft. You can get similar coverage as a rider to your Chubb or Travelers homeowner's policy, and Travelers sells stand-alone identity-theft insurance starting at \$50 a year for \$5,000 worth of coverage. Such protection is valuable if you're self-employed, says Beth Givens, director of Privacy Rights Clearinghouse, an advocacy group in San Diego. On average, you'll have to spend 10 hours over 23 months to right your credit records after identity theft, she says.

Finally, you can go a long way toward protecting your identity by giving it a lower profile. You can find out how to remove your name from junk-mail and telemarketing lists by going to the Direct Marketing Assn.'s Web site (table). A single phone call to 888 567-8688 will alert the three credit bureaus that you want to stop receiving pre-approved credit offers. And Privacy Rights Clearinghouse, at privacyrights.org, has a list of opt-out addresses and phone numbers for many bank and credit-card companies.

Whatever you do, be serious about guarding against potential intrusions into your affairs. If you don't value your financial identity, there's a good chance someone else will.

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THE PAUSE THAT REFRESHES



BY TODDI GUTNER

hers@businessweek.com

Time away from your career, on a paid or unpaid sabbatical, can help to renew your creativity and productivity

In 1998, after 23 years on the fast track, Mary Lou Quinlan hit a wall. "I had burned out after years and years of overdelivering [on the job], and I needed to recharge my batteries," says Quinlan, 47, who was then chief executive of New York ad agency N.W. Ayer & Partners. At the suggestion of a friend, Quinlan asked the company's chairman for a paid, five-week sabbatical. "I will always be grateful he gave me the time," she says, although Ayer had no formal policy.

During her leave, Quinlan, who is married with no children, did nothing work-related. Rather, she caught up on her life and kept her mind free of day-to-day clutter by exercising, touring museums, and visiting friends and family. By the time she returned to Ayer, Quinlan had come up with an idea for a new marketing company that would help clients better understand female customers. Today she runs that business, Just Ask a Woman, a \$2.5 million unit of Ayer's parent, BCom3.

As Quinlan's experience shows, time away from your career may be the best way to advance it. And the good news is, you don't have to be a CEO to get a break. Many companies have sabbatical policies separate from their rules for maternity and family leaves. A 2001 survey by the Society for Human Resource Management found that 19% of the 754 companies polled offered sabbaticals. Within that 19%, 5% provided them with pay. The average size of the company surveyed was 1,600 employees.

Company policies vary from quite liberal to restricted. Mutual-fund researcher Morningstar allows all employees a six-week, paid sabbatical every four years to do whatever they choose. In 1998, Martha Moss, a public-relations manager, fulfilled a dream to travel in Europe and sing with the Austrian Chorale Society. "I returned refreshed and ready to work," says Moss.

Xerox lets U.S. employees who've been with the company at least three years take off for 12 months with pay—but they must work for a nonprofit organization with which they are already affiliated. Some 100 of its 47,500 employees apply each year, and 10 to 15 are accepted—although this year the program is temporarily sus-

pended. In 1999, Susan Goldberg, a Xerox executive in Denver, helped create press materials for the new Brent Ely Foundation, which provides temporary housing and services for families of critically ill children receiving treatment at Denver Children's Hospital. "It was the most wonderful year of my life," says Goldberg, who then turned to Xerox.

If your company doesn't have a stated policy, you still can make a case for getting time off. Now may be a good time to ask as companies look for ways to cut costs to weather the downturn. First, discuss your idea with the human resources manager or with a co-worker who has taken a sabbatical. Ultimately, you must ask your superiors how your leave can benefit the organization—say, by helping to renew your creativity.

If you can't get a paid leave, you may be able to work out the finances by borrowing future vacation and personal time and using allowances you're entitled to for conferences and workshops. "You're just asking for a hand if you're planning an unpaid change," says Quinlan. Make sure you're guaranteed your same job back and find out what happens if your department is reorganized before you return.

HELP WANTED. While many people work out their own agendas, you might strengthen your case by joining an organized program. Many worthwhile groups help you share your professional skills and contribute to a good cause. Among them is Habitat

Humanity International (www.habitat.org, 422-4825), where you volunteer to build housing in poor areas. For a list of such organizations, check with VolunteerMatch (www.volunteermatch.org, 415 241-6868). White House Fellows (www.whitehousefellows.gov, 202 395-4400) offers a paid, year-long program that lets you work alongside federal government leaders to develop public policy.

One such fellow this year is Kimberly Connors, 38, a Santa Clara (Calif.) deputy district attorney who is working with Housing & Urban Development Secretary Mel Martinez. "I'm gathering tools and leadership skills to bring me back to my community," she says. Undoubtedly, she will bring them back to her job as well.



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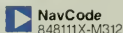
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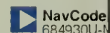
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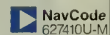
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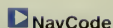


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LET SHAREHOLDERS DECIDE THIS ONE



BY ROBERT BARKER
rb@businessweek.com

There's a simple way to end the running battle between TIAA-CREF and socially responsible investing activists. It's called a shareholder vote

Sadly, I've nearly ruined more than one friendship by debating the merits of socially responsible investing, or SRI, as it's often called. Many people can't bear to own stocks of companies that peddle tobacco or abet a dictatorship. Others don't see such connections, don't care, or, like me, think investing and morality are complex enough issues without mixing the two. SRI can drive reasonable people into irrational, inflexible positions.

Just that is now facing the Teachers Insurance & Annuity Assn.-College Retirement Equities Fund, or TIAA-CREF, the \$260 billion group serving 2.3 million clients, mostly professors and other college employees. It's as classy as money managers come, with a superb record of high returns at low cost. Since 1990, it has offered an SRI option to pension clients. Yet TIAA-CREF is under attack by clients who want it to take SRI further.

Instead of simply avoiding such stocks as tobacco giant Philip Morris and brewer Anheuser-Busch (table), they want the fund to "positively" invest in such ventures as low-income housing or companies developing pollution-control devices. After years of discussions, TIAA-CREF last year concluded that positive SRI in its \$4 billion Social Choice Account is neither feasible nor likely to be cost effective. This year, advocates began staging protests outside the Manhattan homes of TIAA-CREF CEO John Biggs, chief investment officer Martin Leibowitz, and Edes Gilbert, who's on the trustees' corporate governance and social responsibility committee. On Nov. 13, dissidents plan to press the issue further at TIAA-CREF's annual meeting and a demonstration on the street.

Why should anyone without money at TIAA-CREF care? Because TIAA-CREF often serves as a

model investment manager, and because the putte has driven both sides to twist basic principles of investor democracy and fiduciary duty. In me, the issue is not whether positive SRI is worthwhile. It's that TIAA-CREF's pension-account holders—the people whose money is at stake—should be able to make broad decisions about how it is invested. Yet, neither SRI's advocates nor TIAA-CREF appears willing to trust the shareholders. Both sides say I'm wrong to draw this conclusion. But their actions speak louder.

Consider first what proponents of "positive SRI, amid all of their protests, have failed to



They're led by Neil Wollman, a **EVIL WEED:** professor at Manchester College in Indiana. Wollman **Activists target CEO Biggs** knows that a well-established

process exists to bring investment policy questions to a vote. Yet SRI advocates let the dead for filing proxy materials pass. Why? "It is very hard to get 50% of the vote," Wollman told. "It wouldn't be a fair vote, and as soon as we didn't get 50%, they would say, 'Look, it lost

SCREEN SAVERS. TIAA-CREF expresses eagerness for such a vote. But it's quiet about the findings of a survey it commissioned of Social Choice Account participants. Back then, TIAA-CREF said its purpose was "to evaluate how [their] needs and wants are being met, whether any changes should be made." The survey found 81% of contributors to the Social Choice Account favored seeking out "companies who have an outstanding record of good performance on social issues rather than relying on negative screens." Only 3% were opposed.

Common sense dictates that no manager of other people's money, however classy, can escape to every client's political bias. Yet given its strong interest in positive SRI, TIAA-CREF should spend another year pretending the issue is settled and suffering the advocates' street theater. Or it can reopen the issue, make sure it knows what clients want, and then do it.

TIAA-CREF's Social Choice Account

ASSETS \$4 billion

INVESTMENT MIX 60% stocks, 40% bonds and cash

LARGEST HOLDINGS Microsoft, American International Group, Citigroup, Pfizer, Johnson & Johnson

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RECENT PERFORMANCE -7.1%*

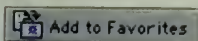
LONG-TERM PERFORMANCE 11.3% average annual total return**

*Year to-date through Nov. 2 **From Mar. 1, 1990, inception through Sept. 30

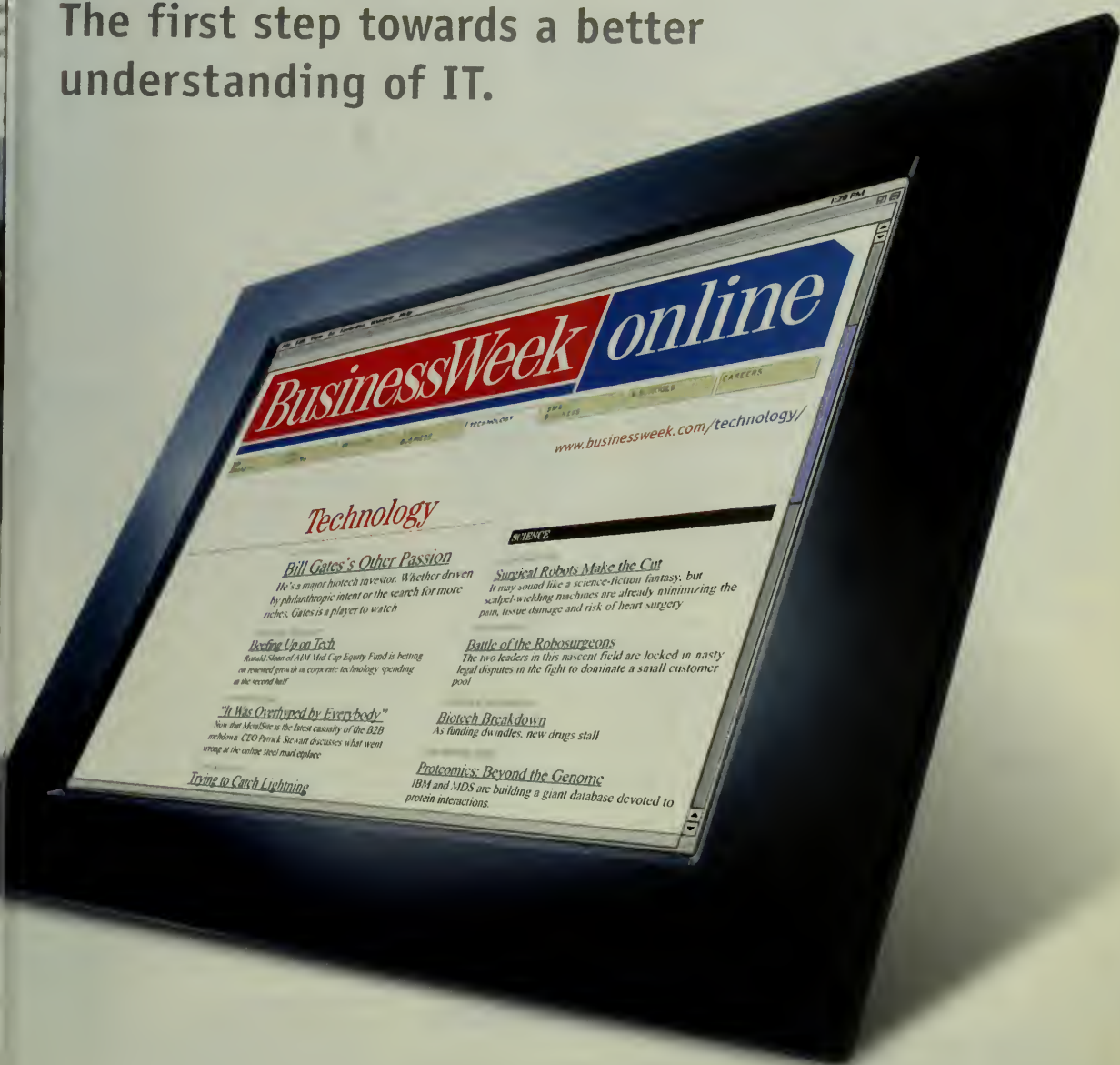
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UNIVISION AND VIACOM?



BY GENE G. MARCIAL

The No. 1 Spanish TV network would be a fit with CBS. Smart cards from Cubic may help foil airport terrorists. In casino bingo, Multimedia Games can hardly lose

Is Univision Communications (UVN), No. 1 in Spanish-language TV in the U.S., being pursued by Viacom? Ever since NBC agreed to buy No. 2 Telemundo on Oct. 11 (page 79), speculation has swirled that Univision would be next. Shares of Univision jumped sharply, to 28, when the NBC-Telemundo deal was announced. Of late, the stock has again attracted some buying: The buzz on Univision has zeroed in on one possible buyer—Viacom, the giant media and entertainment company that also owns CBS.

One big Univision shareholder says that there have been talks between the two but that disagreement on price blocked any merger deal. This investor says Univision CEO Jerrold Perenchio, 70, who owns 18% of the stock and 69% of the voting stock, has confided to friends that he may be more amenable to a deal now. But he won't be inclined to sell at below 50 a share, says this source. Nevertheless, a deal is still very much a possibility. Viacom indicated in May that it wanted to own a Spanish network. Univision reaches 93% of Hispanic households.

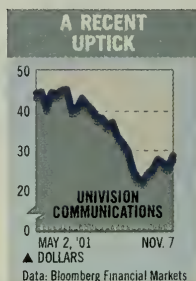
"There's no doubt that Univision is a perfect fit for Viacom," says Timothy Wallace of Banc of America Securities, who rates the stock a strong buy solely on fundamentals. He thinks Viacom CEO Sumner Redstone and President Mel Karmazin both want to own premium assets such as Univision. "I'm very bullish on Univision, which has a market share of 85% in the fastest-growing part of the industry," says Wallace. The Telemundo sale validates the Hispanic market's importance and Univision's value, he adds. If you assume a 20%-to-30% premium valuation for Univision (based on Telemundo's deal), it implies a price of 40 a share or about \$10.8 billion, he says. Viacom and Univision declined comment.

FROM CUBIC: THE I.D. CARDS OF TOMORROW

As a defense contractor supplying electronic systems to the U.S. military, Cubic (CUB) is in one of today's hot businesses. Its shares rocketed from 26 in early September to 36 on Nov. 7. But the ascent may be far from over: Cubic now wants to use its "smart card" technology, currently used for mass-transit systems, for security purposes as well—to help prevent unauthorized entry into sensitive areas. Cubic believes its smart card, now in use for

transit ticketing in Washington and Chicago, could be a base for smart I.D. cards that incorporate fingerprint and facial-recognition technology for security purposes. Recently Cubic formed a unit, Cubic Security, to develop an improved card for the war against terrorism. Cubic says current cards could be adapted for airports, other spots where identity verification is critical. Cubic is working with potential partners in metrics, which include such technologies as fingerprint analysis, hand geometry, voice pattern recognition, and signature and retina-scanning to map physical characteristics.

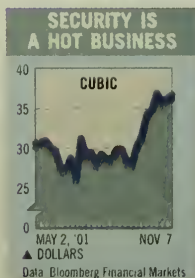
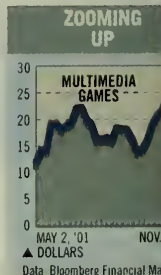
The stock of one security smart-card pure play, ActivCard, doubled in just weeks—although the company has yet to make a penny. "Once Cubic succeeds in upgrading its smart cards, its stock should break out above its resistance level of 39 a share, and move up to the 50-to-60 zone," says Charles LaLoggia, editor of *The Super Investor* newsletter, in Rochester, N.Y. Analyst David Nakashian of Value Line expects Cubic to earn \$2.30 a share in 2001 and \$2.70 in 2002.



MULTIMEDIA GAMES HAS GOT BINGO

Multimedia Games (MGAM) is "one of the most compelling gaming stories." So says David Bain of Roth Capital Partners, who rates it a strong buy. The stock, which zoomed from 4.75 on Nov. 3, 2000, to 28 on Nov. 7, 2001, "is just beginning to reflect the story," he says.

That story is quite unusual: Multimedia Games makes interactive bingo games and related electronic equipment mainly for Native American-owned bingo halls and casinos. Multimedia installs slot-machine-like bingo player stations free of charge. But it keeps 30% of the take: Each machine clears nearly \$200 a day—harvesting \$60 a day for Multimedia. The company's other products include MegaBingo, MegaCash, MegaMania, FlashCash, Bingo Express, and MegaRacing. Multimedia's earnings have been "explosive" in the past three quarters, compared with losses for previous years, says Bain. He sees earnings of 30¢ a share, on revenues of \$45.3 million, in the fourth quarter. For all of 2001, Bain figures Multimedia will earn 80¢ on sales of \$129.3 million, and \$1.50, on sales of \$174.4 million for 2002. But Bain expects the company will beat his estimates for both 2001 and 2002. In 2000, Multimedia posted a profit of 46¢ a share on revenues of \$95.3 million.

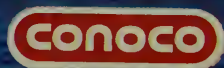


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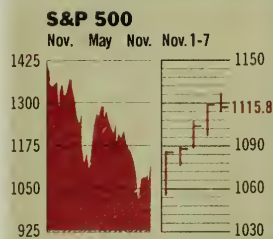
Read Gene Marcial's Inside Wall Street Online column Tuesdays afternoons at www.businessweek.com/today.htm. And see Fridays at 1:10 p.m. EST on CNN's *The Money Game*.

A dramatic photograph of a sunset or sunrise over a body of water. The sun is low on the horizon, creating a bright glow and long, dark shadows across the water. The sky is filled with large, dark clouds that are illuminated from below, giving them a fiery, orange-red appearance. In the distance, a small, dark silhouette of a lighthouse is visible on the horizon line.

Conoco extends our deepest sympathy to all victims and their families.
Our thoughts and prayers are with those who are grieving.



Stocks



COMMENTARY

The market shook off negative economic news such as rising unemployment and weakness in the service sector, and focused instead on continuing productivity gains. The Federal Reserve's 0.5% rate cut didn't hurt. The indexes were led by the Nasdaq's 8.7% gain, followed by healthy moves in the S&P 500 and the Dow Jones Industrials, which both jumped 5.3%.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Nov. 7	Week	Year to date	Last 12 months
S&P 500	1115.8	5.3	-15.5	-22.1
Dow Jones Industrials	9554.4	5.3	-11.4	-12.8
Nasdaq Composite	1837.5	8.7	-25.6	-46.2
S&P MidCap 400	471.9	4.7	-8.7	-10.6
S&P SmallCap 600	209.4	3.2	-4.6	-4.5
Wilshire 5000	10,279.2	4.9	-15.6	-23.3

SECTORS

	Nov. 7	Week	Year to date	Last 12 months
BusinessWeek 50*	730.0	4.9	-24.8	-37.2
BusinessWeek Info Tech 100**	399.6	7.4	-29.4	-50.9
S&P/BARRA Growth	579.0	6.0	-15.8	-28.6
S&P/BARRA Value	536.5	4.6	-15.7	-15.8
S&P Energy	803.8	-1.0	-13.7	-12.0
S&P Financials	144.0	6.5	-12.6	-10.6
S&P REIT	89.3	1.7	1.5	9.8
S&P Transportation	643.4	6.6	-7.8	-4.6
S&P Utilities	243.3	-0.9	-30.6	-25.1
GSTI Internet	91.3	11.4	-49.8	-75.1
PSE Technology	653.6	9.1	-19.7	-34.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Communications Equip.	30.8	Engineering & Constr. 57.1
Semiconductors	26.4	Specialty Printing 47.4
Invest. Banking/Bkrge.	22.8	Toys 44.1
Oil & Gas Drilling	19.6	Paper Containers 44.0
Apparel Manufacturing	18.5	Gold Mining 43.4

GLOBAL MARKETS

	Nov. 7	Week
S&P Euro Plus (U.S. Dollar)	1038.8	3.5
London (FT-SE 100)	5216.3	3.5
Paris (CAC 40)	4493.3	3.5
Frankfurt (DAX)	4860.7	6.6
Tokyo (NIKKEI 225)	10,285.0	-0.8
Hong Kong (Hang Seng)	10,269.8	1.9
Toronto (TSE 300)	7147.3	3.8
Mexico City (IPC)	5638.0	1.8

FUNDAMENTALS

	Nov. 6	Wk. ago
S&P 500 Dividend Yield	1.40%	1.41%
S&P 500 P/E Ratio (Trailing 12 mos.)	45.8	42.1
S&P 500 P/E Ratio (Next 12 mos.)*	21.2	20.2
First Call Earnings Revision*	-7.11%	-9.3%

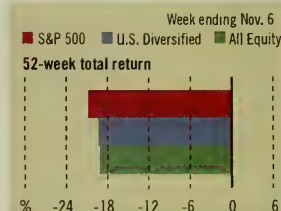
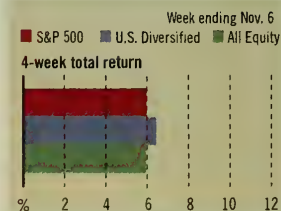
TECHNICAL INDICATORS

	Nov. 6	Wk. ago
S&P 500 200-day average	1197.3	1203.2
Stocks above 200-day average	43.0%	35.0%
Options: Put/call ratio	0.69	0.87
Insiders: Vickers Sell/buy ratio	1.52	1.55

WORST-PERFORMING GROUPS

	Last month %
Photography/Imaging	-23.0
Natural Gas	-21.6
Savings & Loans	-15.3
Regional Telephone Cos.	-11.8
Hospital Management	-10.8

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Technology	18.5	Precious Metals	29.6
Latin America	10.2	Real Estate	11.7
Small-cap Growth	8.8	Small-cap Value	7.7
Mid-cap Growth	8.7	Mid-cap Value	5.3
Laggards		Laggards	
Utilities	-2.9	Technology	-55.2
Precious Metals	-0.2	Communications	-50.2
Real Estate	0.1	Japan	-38.3
Natural Resources	0.8	Mid-cap Growth	-34.7

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
ProFunds UltraOTC Inv.	45.6	Potomac Internet Short	146.1
Conseco Science & Tech. A	35.1	CGM Focus	79.1
Red Oak Technology Select	34.5	Schroder Cap. Ultra Inv.	78.8
PIMCO Global Innovation C	30.3	Rydex Dynamic Vent. 100	72.2
Laggards		Laggards	
ProFunds UltraShort OTC	-37.3	ProFunds UltraOTC Inv.	-86.2
Rydex Dynamic Vent. 100	-36.3	Potomac Internet Plus	-80.9
Potomac OTC Short	-20.1	Van Wagoner Technology	-80.9
Rydex Arkto Investor	-19.9	Van Wagoner Post Venture	-80.8

Interest Rates

KEY RATES	Nov. 7	Week ago
MONEY MARKET FUNDS	2.53%	2.53%
90-DAY TREASURY BILLS	1.78	2.01
2-YEAR TREASURY NOTES	2.29	2.42
10-YEAR TREASURY NOTES	4.18	4.23
30-YEAR TREASURY BONDS	4.79	4.87
30-YEAR FIXED MORTGAGE†	6.37	6.46

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	3.89%
TAXABLE EQUIVALENT	5.64
INSURED REVENUE BONDS	4.11
TAXABLE EQUIVALENT	5.96

THE WEEK AHEAD

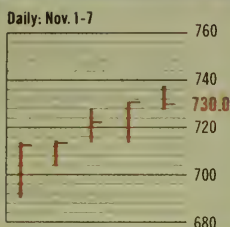
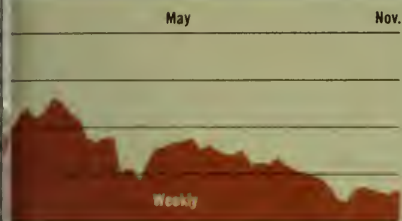
RETAIL SALES *Wednesday, Nov. 14, 8:30 a.m. EST* ▶ Retail sales probably increased 1.5% in October, after tumbling 2.4% in September. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. The projected gain in sales is due primarily to the tremendous incentives auto manufacturers enacted in the wake of the September 11 attacks. Excluding autos, sales were probably unchanged, after falling 1.6% in September.

BUSINESS INVENTORIES *Thursday, Nov. 15, 8:30 a.m. EST* ▶ Inventories in September are forecast to have declined 0.2%, after falling 0.1% in August. Inventories have fallen for seven consecutive months, and the trend will likely hold as demand continues to rapidly deteriorate.

CONSUMER PRICE INDEX *Friday, Nov. 16, 8:30 a.m. EST* ▶ Consumer prices for goods and services are projected to have slipped 0.1% in October, after increasing 0.4% in September. Core prices, exclud-

ing the more volatile food and energy components, likely increased 0.1% in October, after a 0.2% rise in September. A slowing global economy and falling energy prices are keeping inflation in

INDUSTRIAL PRODUCTION *Friday, Nov. 16, 9:15 a.m. EST* ▶ Factory output probably dropped 0.8% and capacity utilization likely sunk to 74.8% during October, based on the S&P MMS survey. In September, output fell 1.0%, and capacity utilization declined to 75.5%.

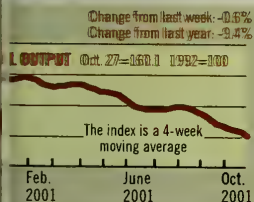


ing for the BW 50, which rose 4.9% for the week. Leading the charge were such technology bell-
 nx, up 24.6%, Sun Microsystems, 24.0%, and Mercury Interactive, 23.0%. But tech was not the
 length: Financials heavyweights Merrill Lynch and Morgan Stanley leaped 12.1% and 10.1%, re-
 poorest showing came from Provident Financial, which fell another 28.8%.

COMPANY PERFORMANCE

any	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
national	8.0	-2.8	26	Verizon Communications	0.1	2.9
Petroleum	0.0	-10.1	27	Citigroup	5.7	-1.1
	-1.4	-45.0	28	Sun Microsystems	24.0	-37.2
	-8.1	-29.6	29	Merck	1.5	-18.8
aterials	15.3	-13.2	30	El Paso	-4.7	-34.2
Financial	-28.8	-94.4	31	Altera	21.6	-3.2
l Petroleum	0.3	6.4	32	Marsh & McLennan	6.1	-2.6
	-1.7	-14.4	33	Household International	12.3	0.5
ee	-2.9	-13.5	34	ChevronTexaco	-1.4	0.5
	14.9	-27.1	35	SBC Communications	-0.2	-16.4
rothers Holdings	7.7	-1.5	36	Mercury Interactive	23.0	-50.3
	21.9	-65.0	37	AOL Time Warner	10.9	-21.6
	-6.5	-76.3	38	Washington Mutual	2.4	-8.2
oratories	-1.2	9.4	39	General Dynamics	0.5	22.2
on Financial	9.7	-12.0	40	Comcast	4.9	-13.5
chnology	13.8	-27.9	41	Morgan Stanley Dean Witter	10.1	-15.3
	24.6	-8.7	42	Tellabs	2.3	-67.7
less	-0.8	-19.5	43	Exxon Mobil	-0.9	-4.0
gy	-2.6	-9.5	44	Scientific-Atlanta	10.2	-50.1
ommunications	-17.4	-66.0	45	U.S. Bancorp	3.1	-21.2
e Financial	20.5	-10.8	46	Paychex	8.0	-12.2
roleum	2.2	4.0	47	Merrill Lynch	12.1	-18.3
ervices	19.1	9.8	48	Bed Bath & Beyond	16.2	16.2
urces	-0.3	-19.2	49	Texas Instruments	13.8	-1.7
wealth	-4.8	-4.2	50	Teradyne	13.7	-15.5

Production Index



index dropped again during the latest
 iculation of the four-week moving aver-
 sunk to 158.8, from 159.4. After sea-
 nts, steel production declined steeply
 ide-oil refining, and rail-freight traffic
 Truck assemblies, electric power, coal,
 e all higher for the week. Through Oc-
 uction index declined to 160.1, from
 ber.

h of the index components is at www.businessweek.com
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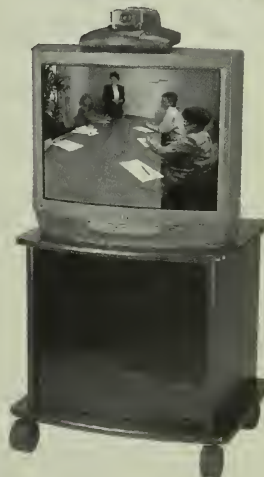


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SLAPPING MICROSOFT'S WRIST

The antitrust case against Microsoft Corp. has always been a tangled web of complex technologies, economic trade-offs, and unsatisfying remedies. War and recession muddy the situation even further. We admit to a certain sympathy for the Bush Administration's desire to settle the case now to clear the decks and focus on higher priorities—fighting the war in Afghanistan, bolstering home security, and restoring economic growth. But the Justice Dept.'s weak censure of Microsoft for its serious monopolistic practices could cost the U.S. mightily in the years ahead. The great strengths of the American economy are its openness, its competitiveness, and its innovativeness. Monopoly is the enemy of all three.

The truth is that the Justice Dept. basically chose to ignore the findings of a federal district court and the U.S. Court of Appeals, which determined that Microsoft engaged in a pattern of monopoly behavior. It chose to deny information showing that the company spent enormous energy on maintaining its Windows platform monopoly while undermining threats from rivals. In agreeing to mild remedies, the Justice Dept. sends the wrong message to the marketplace.

The settlement as it now stands is riddled with loopholes. It tells Microsoft to stop bullying personal-computer makers and mandates that Microsoft offer fixed prices to all computer makers so they cannot be punished for loading non-Microsoft applications. But the remedy still allows Microsoft to charge whatever it wants for its Office suite software, which is loaded onto most PCs. Microsoft retains a huge club to wield over computer makers that cross it.

Furthermore, the settlement applies only to PCs, not handheld devices or some servers. This remedy needs to be tightened up considerably.

The settlement also tells Microsoft to share Windows operating-system code with competitors so they can write new programs that work seamlessly with those systems. But it allows Microsoft to wait until after it sends out 150 million copies of its beta, or testing, software to begin to share. This is far too late for rivals to start competing with Microsoft's own teams of applications writers, who know the market from the start. This remedy also should be tightened up.

Perhaps the most serious problem is that the settlement does nothing to keep Microsoft from leveraging its Windows monopoly on PCs onto the Web by bundling its MSN portal, instant messaging, e-mail, and streaming-media applications. Bundling applications into the monopoly operating system while making it difficult for rivals to connect to the OS standard, is at the heart of the Microsoft antitrust case. Microsoft shows few signs of ending its past behavior. It has already raised the ire of Eastman Kodak Co. and Real Networks Inc. by writing an early version of XP that funnels customers to Microsoft's own photo and media sites.

Striking a balance between consumer convenience and innovative competition is always difficult, and much more so in an era of technological change. The Justice Dept. in its recent settlement with Microsoft fails to strike that balance. Caving in on the issue of monopoly, it leaves a serious problem that could haunt the country's economy for years.

THE STIMULUS PACKAGE, PRO AND CON

Washington's partisan war over fiscal stimulus for the ailing economy is taking so long to resolve that it probably will come too late. Thanksgiving is the earliest any fiscal package can be expected to pass. Economists are estimating that an economic recovery will probably begin next spring, long before the full effects of any stimulus plan can be felt. The real goal now is to take out insurance against the chance that the recession turns into a rout, especially if renewed terrorism erodes confidence.

The record of fiscal stimulus is that it can stop an economy from spiraling downward but can't, by itself, create recovery. Monetary policy is a far more effective tool for generating growth. Indeed, the most important aspect of any fiscal stimulus is size—it must be big enough to brake economic decline but not too large to kick a recovery into inflationary overdrive. On this criterion, the current package of proposals gets winning grades. It appears Washington will pass a stimulus bill equal to 1.5% to 2% of gross domestic product.

There are a few turkeys among the many stimulus proposals being discussed in Congress. Helping corporations im-

prove their balance sheets is a good policy objective. But repealing the alternative-minimum tax and refunding back payments are not. They favor a handful of capital-intensive companies, not a wide range of businesses across the economy. And they don't provide any incentive for future investment in new productivity-enhancing equipment. A big tax cut that provides for faster depreciation for new equipment is better insurance against a severe recession.

Bolstering consumer balance sheets is good insurance. Only 18% of the \$40 billion in rebate checks mailed out last summer was actually spent, according to the New York Federal Reserve. Taxpayers are trying to get in better financial shape, deal with unpredictable events, and prepare for the recovery whenever it arrives. So are those workers who earned too little to receive tax rebates last summer. A temporary increase in payroll taxes for them is a good idea. And extending health benefits for workers who have lost jobs, another proposal, is simply the right thing to do.

These are exceptionally uncertain times. The economy needs to use all the insurance it can get.

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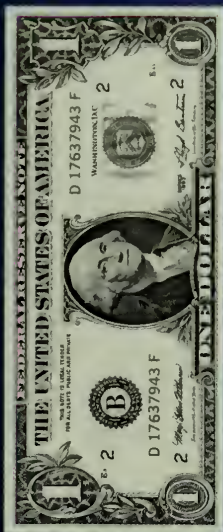
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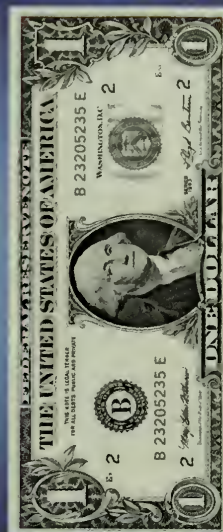
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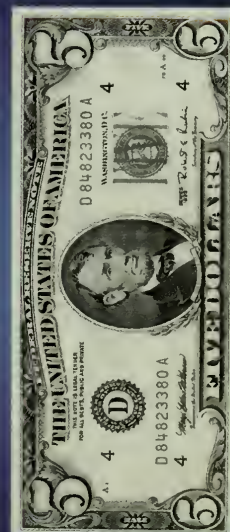
CONFUSED ABOUT EARNINGS?



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You're not alone.
Here is what companies
should do—and what
investors need to know.

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“The infrastructure of e-business has become a mission critical component of today’s global enterprise,” says The Aberdeen Group.

PUT LESS DELICATELY, an e-business without the right infrastructure is living on borrowed time. The promise of e-business – to cut costs, improve customer service and streamline business models – means nothing if your company’s infrastructure isn’t ready for it.

So what is it? Why do you need it?

Infrastructure is the great invisible enabler. The stuff behind the wall. Servers, software, middleware, routers, storage – the things people never see. It’s end to end. Top to bottom. It’s your e-business skeleton.

Yet most of it wasn’t designed for e-business. And now the Internet’s explosive growth, the sudden connection of every system to every other system, and advances like “always on” wireless devices are testing it in ways designers never imagined. When computers go down, it’s inconvenient. If infrastructure goes down, e-mails bounce, systems crash and customers go elsewhere.

Is it a technical issue? Is it a strategic issue?

The issues of e-business infrastructure: how do I get 20 platforms to work together seamlessly? Can we handle 3 million transactions an hour? Is it more cost effective to connect 30 small servers or consolidate on one massive server? How fast can I deploy?

These are not just technology questions – they’re questions at the heart of how a business is organized and operated. And the answers vary, depending on market conditions, industry type and company size.

IBM is uniquely suited to help business strategists navigate this perilous turf – where a misstep today can cost millions of dollars tomorrow. We understand the

business issues and how technology impacts and shapes them.

Do small companies need to worry about infrastructure?

They do if they want to become big companies. Pity the CEO whose business strategy increases online orders by 500%, but whose infrastructure can’t handle the systemwide chain reaction. IBM infrastructure solutions are flexible and scalable – whether we help you build one from scratch or rent it to you as an outsourced e-business package. Plan for growth or you may pay for the oversight.

What about Linux®?

IBM has committed thousands of developers and technical support experts to Linux for two reasons: choice and interoperability. Never again will you be forced to adapt your processes to the only software available. With Linux, you just adapt the software to suit. In addition, Linux loves all kinds of hardware. Such openness makes it easy for you to integrate disparate platforms and create single, seamless e-business infrastructures.

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NOTHING DISMAL ABOUT THESE GUYS

Editorial discussions at our morning news meetings range far and wide, from Yahoo! to the Yankees, from Bill Ford to Harry Potter. But we always talk about the economy. This week, we mark the retirement of three people who have been our colleagues and friends for many years: Chief Economist William Wolman, Senior Editor Seymour Zucker, and Economic Trends' Gene Koretz. They have been involved in thousands of articles about the dismal science, dozens of cover stories, and—since they are economists—millions of arguments.

Beyond their individual contributions, these three helped make journalistic history. It was *BusinessWeek* in the 1950s and 1960s that invented the coverage of economics as news—that is, as a subject important and interesting enough to warrant attention on a regular basis, not just in academic journals but in a popular weekly magazine.

The prime mover in this trend in the 1950s was Leonard Silk, a PhD economist-turned-journalist who worked at *BusinessWeek* for many years and later at the *New York Times*. In 1960, Silk hired a young academic, also an economics PhD, named Bill Wolman. A Montreal native, Wolman had graduated from McGill University and earned his doctorate at Stanford University. At that moment in 1960, he was an assistant professor of economics at Washington State University in Pullman.

BusinessWeek's pioneering coverage, particularly in the 1960s, brought academic economists to the business community and to the general public for the first time. The magazine popularized the field and its leading practitioners—explaining Keynesianism and monetarism to us—and intro-

duced us to the giants of the economics profession, from Paul Samuelson and Milton Friedman to Wassily Leontief and Arthur Okun.

Silk left in 1969, and for much of the next 30 years, it fell to Bill Wolman to lead the charge. But Wolman did more than pioneer a field. He helped to build a tradition of the magazine that continues today and remains

one of our great strengths. He won many major journalism awards, including a National Magazine Award, and is a well-known television commentator.

Over the years, we've had PhD economists who became journalists and journalists who mastered economics. Zucker and Koretz best represent these two archetypes. Seymour Zucker is a Brooklyn native who earned a PhD in economics from the



ZUCKER

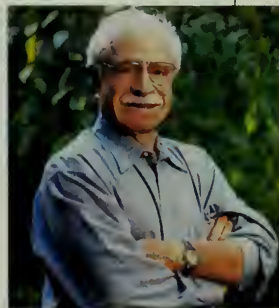
New School for Social Research. Zucker may have been a greenhorn in journalism, but he became one of the very best editors at *BusinessWeek*.

Gene Koretz came not as an economist but as a copy editor. A native New Yorker, he graduated from George Washington High School a few years after Alan Greenspan, and, at Indiana University, got as far as completing the course work for a PhD in English literature. From the *BusinessWeek* copy desk, he soon gravitated to reporting and writing, mastering the rare ability to translate arcane material into thoughtful journalism. Koretz' Economic Trends column developed a wide following, part of the smorgasbord that makes a great magazine.

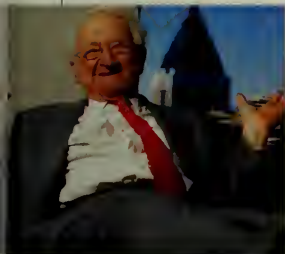
Many other newspapers and magazines now cover the economy, but our job remains the same: to be on the leading edge of new thinking; to identify important people, trends, and ideas; and to do the best possible business-cycle analysis. In the process, we aim to be nonpartisan. We don't embrace any one particular ideology—whether Keynesian, monetarist, or supply-side. We examine them all and try to bring to bear intelligent and fair-minded analysis.

Economics is not a science: Reasonable people will disagree, and they certainly do. Over the years, our staff members have argued passionately among themselves and in these pages. We encourage this. We promise to keep the debate civil, rational, and nonpersonal. No one has a monopoly on economic wisdom.

We will miss Bill, Seymour, and Gene. But *BusinessWeek* still has a great group of people covering this important field, including Michael J. Mandel, James C. Cooper, Peter Coy, Kathleen Madigan, Rich Miller, Laura Cohn, Christopher Farrell, James Mehring, and Margaret Popper. They are joined by our rotating Economic Viewpoint columnists, Robert J. Barro, Gary S. Becker, Jeffrey E. Garten, Robert Kuttner, and Laura D'Andrea Tyson. Covering economics is an important mission, and we know that you, our readers, are counting on us to maintain an honorable tradition.



KORETZ



WOLMAN

Stephen B. Sheppard

Editor-in-Chief



e.g. Chrysler PT Cruiser



e.g. Mercedes-Benz C-Class



e.g. smart City Coupé



e.g. Dodge Dakota



e.g. Jeep Liberty



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A full-page photograph of an elderly woman with short, wavy grey hair, wearing dark sunglasses, a green and white striped sleeveless dress, a lei of purple and yellow flowers, and green sandals. She is standing on a black and white striped beach mat on a sandy beach. The ocean is in the background under a clear sky.

You networked your home 4 years ago.

Your family 2 years ago.

Cripes, you even networked your grandma last year.

Isn't it time you networked your data center?

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Introducing the Sun Fire™ 15K, the mainframe-class server for today's networked data center.

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In fact, the Sun Fire 15K server is so powerful, you can consolidate multiple servers and rehost mainframe applications, as well as deploy new mission-critical applications in an open environment. And unlike a mainframe, the Sun Fire 15K server easily integrates into your existing architecture. The Sun Fire 15K server has complete end-to-end system compatibility with the Solaris™/SPARC™ architecture, so you use the same tools, applications, administration and resources to deploy and manage it. No recoding, no retraining and no expensive consultants to come in and “manage” it for you.

A revolutionary concept in data centers: reduced costs.

The result of all this? A significantly lower total cost of ownership. In the end, by incorporating the new Sun Fire 15K server into your existing architecture, you can reduce your data center's complexity, take control and cut your costs. So take the first step toward liberating your data center—and your bottom line. www.sun.com



Product specifications (the rocket science):

- 106 CPUs – the largest in a single cabinet
- 1/2 terabyte memory – run a database in main memory
- 18 domains – for the utmost in balanced workloads
- 4 petabytes of storage – 20x the Library of Congress
- 6,400 mainframe MIPS – 3x the IBM z900
- 5th-generation fault-isolated dynamic system domains
- Sun™ Fireplane interconnect – maximum app performance
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Sun offers software developers an unparalleled open and compatible architecture in which to develop and deploy their solutions. This single integrated system architecture allows customers to protect their investments, leverage their existing skill sets and staff, and increase their ROI. It's the reason ISVs like BEA Systems, i2, J.D. Edwards, Oracle and VERITAS partner with Sun.

take it to the nth





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COVER STORY

EARNINGS CHAOS

Companies keep concocting their own ways to calculate earnings until they come up with one that yields a crowd-pleasing number.

That has to stop *page 76*



Cover Story

76 CONFUSED ABOUT EARNINGS?

There are no rules for calculating operating earnings—the number investors watch—as there are for net profits, which are filed with the SEC. So companies are making up their own rules about what to add and what to leave out, and calling the result “earnings.” That makes it impossible for investors to compare companies and threatens the credibility of the U.S. financial system. Here’s what should be done—and what investors need to know

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Check on the health of your investments



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Use more than 70 criteria to pan for gold among the equities



■ **MBA SEARCH:** Which is the right business school for you and your needs?



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Slipping Grip

More internal turmoil at handheld king Palm only makes its other woes—including an aging operating system and low-margin models—even worse



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Up Front

EDITED BY
SHERIDAN PRASSO

SILICON SAGAS

HEWLETT'S HUE AND CRY

ON NOV. 6, HEWLETT-Packard board member Walter Hewlett shocked investors by saying he would vote the 5% HP stake he controls against the \$23.5 billion merger with Compaq. But HP's board couldn't have been surprised. Hewlett expressed doubts about the deal throughout the summer. "He voted as a director for the deal, but he didn't make it clear" that he would vote yes with his shares, says an insider.

As Hewlett watched HP's shares drop this fall, he grew increasingly concerned about the value of his parents' foundation and hired a financial consultant for advice. He also missed part of a July board meeting on the merger, choosing instead to play in an annual concert at a retreat called Bohemian Grove. Hewlett's lawyer, Steven Neal, says Hewlett has missed the Thursday portion of that meeting for three years for the same reason. "[HP] made the choice to discuss the deal when they knew he wouldn't be there," says Neal, who notes that the board has pre-



viously saved important topics for the Friday session. An HP insider says the board assumed he would skip the concert for a critical meeting.

While Hewlett has little business background, his 'no' vote could hurt the merger's chances. David Woodley Packard, son of co-founder Dave Packard, quickly backed Hewlett up. If Packard's parents' foundation votes no with its 10% stake, HP faces a tough proxy fight.

Still, HP execs hope to win investors' support—including the foundations—with a vote in early 2002. In this corporate soap opera, anything can happen. Hewlett was part of the committee that O.K.'d hefty bonuses to keep top executives on board through the merger. Chief Executive Fiorina has waived her bonus. That would have paid her \$8 million, and, no doubt, riled shareholders even further.

Peter Burrows

THE LIST ONLINE FLAG WAVING

Patriotism and flags dominate most of the Web sites drawing significant numbers of visitors for the first time in October*

usaflags direct.com	3.5 million	Phoenix-based company sells flags and patriotic paraphernalia
deskflag.com	3.1 million	Download site for U.S. flag icon that waves on computer screen
tigertech.com	2.4 million	Parent site for the deskflag.com icon; also allows for download
freefinancial secrets.com	1.6 million	Advice on managing personal finances and debt
homeofthe freeonline.com	1.3 million	Gives away flag decals for a \$2 shipping charge

*Web sites with more than 500,000 monthly visitors Data: Jupiter Media Metrix, BusinessWeek

TALK SHOW "It takes an awful lot to stop Americans from spending money."

—Economist David Wyss of Standard & Poor's, a unit of The McGraw-Hill Companies, on October's retail sales surge.

HOMELAND DEFENSE

PAYING THE FREIGHT FOR SAFER SKIES

HOW MUCH WOULD IT COST TO make planes secure enough to prevent another September 11? Less than \$20 per person per flight, based on calculations by University of California at Irvine economist Peter Navarro.

First, we'd need 40,000 sky marshals, two per flight: \$6 billion a year. Then there's the proposed federal takeover of airport security. Additional guards, up from 18,000 to at least 25,000, and increased pay from an average \$15,000 a year to \$35,000: about \$1 billion—\$400 million less if they are not federalized (due to lower overhead). Retrofitting 9,000 cockpit doors: \$450 million. New technologies, such as retinal scanners for passenger profiling: \$2 billion a year.

Total: about \$9 billion a year. A lot of dough? Yeah. But

divide that by a sharply reduced number of one-way flights, say 525 million comes out to about \$35 round-trip ticket.

Of course, someone has to pay, and that's what Congress is trying to resolve. For American Airlines CEO Robert Crandall argues against the surcharges, saying that



SAN FRANCISCO: On guard

every \$1 increase, a million people don't travel. Proposals in Washington suggest charges of just \$5 a ticket tops. So who pays the rest?

Christopher Palmeri, Lorraine Woellert and Walter Zellner

TECH TALK

IS LINUX CATCHING THE BIG MO?

AMAZON.COM HAS TOLD THE Securities & Exchange Commission that it cut its quarterly tech budget by 24%, or \$17 million, mostly by using Linux software. Can this David to Microsoft's Goliath save companies millions?

More companies are betting it can. In the past six months, McDonald's said it will use Linux in 4,000 franchises. Royal Dutch/Shell will use it to image oil fields. Pixar, DreamWorks, and other special-effects shops are embracing it, too. "They're adopting Linux very heavily," says Bill Claybrook, research director at Aberdeen Group in Cambridge, Mass.

The reason: Linux, an

"open-source" system that can be downloaded for free as a cheap alternative to Windows and to the Unix software sold by Sun, IBM, Hewlett-Packard. Over the years, some companies use Linux instead of Unix can cost by 50%, says International Data Corp. V. President Dan Kusnetzky.

Linux



estimates that Microsoft has a 4% share of the server software shipments, with Linux No. 2 at 27%.

Amazon is tight-lipped about its savings. The company says only that cost reductions "primarily reflect our migration to a Linux-based technology platform" most likely from Unix—a "general price reductions" in data and telecommunications services. Linux may well be headed for a growth spurt.

Kimberly Weiss



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Up Front



MARK: Now just a bystander

AFTERLIVES

FREE AND CLEAR OF ENRON'S WOES

BACK IN ENRON'S HEYDAY, one of its rising stars was Rebecca Mark. Nicknamed "Mark the Shark" because of her ferocious ambition, she made her name in the early '90s building the energy giant's international operations, including the now-troubled Dabhol power plant in India. Once rumored to be a successor to Enron CEO Ken Lay, she resigned from Enron in August, 2000, after two years of heading Enron's ailing water company spin-off, Azurix.

These days, as Enron struggles to stay afloat, Mark-Jusbache (who hyphenated her name with that of her husband of two years) is watching the action from the sidelines. And she'd like to keep it that way. "I'm very surprised and saddened by [what has happened at Enron], and I wish them all the best," she says. Beyond that, Mark-Jusbache, 47, is not much interested in talking about Enron, which is being acquired by a small rival after a spectacular Wall Street flameout. Mark left Enron with millions of dollars worth of Enron shares, although she says she has sold them since.

Mark-Jusbache spends most of her time serving on advisory boards, both at Yale and Harvard business schools, as well as the school where her 16-year-old twin sons from a previous marriage are sophomores.

In her spare time, she seeks out opportunities for investing. Currently, Mark-Jusbache is considering alternative-energy and water-technology companies. A farm girl from Missouri, she has one investment focus that's especially dear to her heart: looking into expanding her cattle ranches. She now owns 15 acres in New Mexico. "I'm doing things that are fun, interesting, and important to me—family and community," she says. Sure beats being anywhere near Enron.

Stephanie Anderson Forest

AS THE DOWNTURN TURNS

WANT TO FIND OUT YOUR chances of getting laid off by the end of next year? Just type your Zip Code, industry, occupation, and performance-review rating into the Layoff Calculator, on a Web site run by economy.com's forecasting unit, The Dismal Scientist (www.Dismal.com).



The median probability of being laid off in 2002 is 5%, according to the site, but it varies widely, of course, by industry: A health-care services manager in Minneapolis with a midrange performance rating has just a 3.7% chance of getting the ax. A financial analyst in New York with a midrange performance rating has a 7.7% chance of getting canned. That's one in 13, folks. Feeling lucky?

Julia Cosgrove

DRAWN & QUARTERED



TOY STORY

G.I. JOE HEROICS AT HASBRO

HASBRO MAY HAVE A HIT on its hands this Christmas—G.I. Joe as a search-and-rescue firefighter. Hasbro drafted him 15 months ago, long before September 11. Now, renewed respect for firemen is likely to help holiday sales. The \$24.99 rescuers, with black garb for East Coast fighters and tan for West Coast ones, hit stores in mid-September. "Everyone's excited about the firefighter," says J. F. K. Sullivan, a buyer for the K-B Toys chain. "They've upped ship-



G.I. FIREMAN

ments significantly." Sales of all 60 G.I. Joe incarnations are up a dramatic 56% year-on-year through the

fall. Brian Goldner, president of Hasbro's U.S. toy group, thinks the rescuers will do extremely well for Christmas. "Policemen, firefighters, military are all part of G.I. Joe brand stories. These are all among the most heroic people in our society."

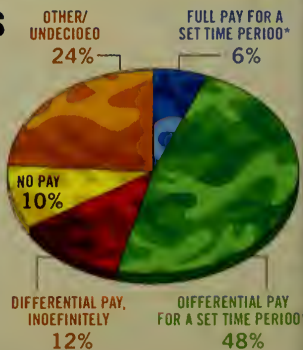
Hasbro, based in Pawtucket, R.I., could use some heroics. Last year, it lost \$145 million on sales of \$3.8 billion as once-hot Pokémon and Furby cooled. This year, Hasbro added the Monsters, Inc. and Harry Potter licenses. With hot lines like that, the new G.I. Joe may not need to come to the rescue.

Faith Keen

THE BIG PICTURE

PAYING RESERVISTS

With many of the nation's 1.3 million reservists called up, companies have had to dust off their policies for compensating them. Most pay reservists only the difference between their military pay and their salaries, but a few pay the full salaries anyway.



SURVEY OF 51 COMPANIES WITH A TOTAL OF APPROXIMATELY 500,000 EMPLOYEES, SEPT. 20-25
Data: Watson Wyatt Worldwide
*AN AVERAGE OF 6 MONTHS

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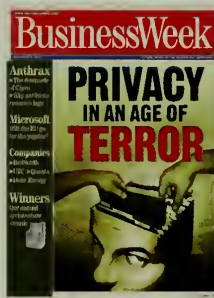
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IS PRIVACY, TOO, A VICTIM OF TERRORISM?

"Privacy in an age of terror" (Cover Story, Nov. 5) is so clear-sighted and honest that I'm surprised it was published in the U.S. Certainly, there is some (qualified) public support for programs that protect citizens from terrorist attacks, and some of those programs will allow government agencies greater access to citizens' data. However, private industries are also interested in our data—to cross-market their products, set insurance rates, deny medical coverage, and set customer service levels. *BusinessWeek* deserves credit for trying to help readers make sense of a complex set of issues—issues that certainly deserve more public discussion and attention in the media than they are getting.

Carl Turner
Normal, Ill.



tive information. Forgery of such a should carry severe penalties to reduce the temptation present with today's working system.

Robert A. Mu
Lakeway,

For years, the U.S. legislative regulatory focus has been on protecting individual privacy. However, the war on terror will not be won quickly, and acts of terrorism, criminal activity, may not be permanently eradicated. A sunset provision in part of the new anti-terrorism/anti-crime bill is limited and can easily be extended so it will be difficult to reverse the process to reestablish the primacy of privacy over security. The bottom line is greater security will permanently trump expanded privacy protection.

Peter C
Chevy Chase,

WEANING THE WEST OFF MIDDLE EAST OIL

We are handcuffed in our foreign affairs by our dependence on the Middle East for oil ("What to do about News: Analysis & Commentary, 29). President Kennedy put us on a moon with one statement in the early Sixties. President Bush should please that by the year 2009, the U.S. no longer be dependent on oil from the Middle East.

Neal Greenb
Fremont, C

Billions of gallons of gas are wasted each year because traffic lights are state-of-the-art. Let's do a quick, ba

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CORRECTIONS & CLARIFICATIONS

"The FTC Refuses a Potent Cocktail" (In Business This Week, Nov. 5) incorrectly stated that General Mills Inc. bought the Pillsbury unit of Vivendi Universal. It purchased Pillsbury from Diageo PLC.

of-the-envelope calculation: *BusinessWeek* stated that American cars and trucks burn 120 billion gallons of gasoline each year ("The eco-cars," Special Report, Aug. 14, 2000). The Environmental Protection Agency assumes that 55% of all driving is in cities, while the Sierra Club says it's closer to 75%. Let's split the difference and say 65% of all driving takes place in town. This means that at least 78 billion gallons are burned in city driving each year. "Smart" traffic lights and better traffic management should be able to save at least 15% of this—or 12 billion gallons of gas a year!

Al Kraig
Harrisonburg, Va.

Other than the gigantic Big Oil-automotive lobby, why is it that in almost 100 years, we haven't come up with anything better than the internal combustion engine?

Dave Jung
Colonial Heights, Va.

Well, how about alternative energy? Now that the laughter has died down, let me bring up a realistic alternative source of energy: biomass (grain, agricultural residue, wood, wood waste, etc.). It can be burned to generate electricity or distilled for internal combustion engines. Biomass, much more than just an incremental source of energy, could ease both the oil crisis and the agricultural crisis in the U.S.

Joseph Z. Bako
Vancouver

A mass adoption of hybrid vehicles and a dramatic reduction in the number of SUVs sold would eliminate all Middle Eastern oil imports over a short period of time. Increased gas taxes are all that is required to make this switch happen.

David Siegel
New York

You omitted natural gas vehicles (NGVs). NGVs are clean, reliable, and safe. Natural gas compressed into tanks in the vehicle is cheaper than gasoline or diesel. Already there are about 100,000

NGVs in the U.S. There are nearly 2 million around the world—a figure far greater than for vehicles powered by any other alternative fuel except liquefied petroleum gas.

Garth Harris
International Association for
Natural Gas Vehicles
Auckland, New Zealand

WHAT SHOULD STRIKE TERROR IN DRUGMAKERS' HEARTS

"Big Pharma" needs an assurance of big profits before getting too involved with antibiotics for terrorist-inflicted bugs, or else there isn't much "incentive" to produce them ("How to get Pharma's big guns aimed at microbes," News: Analysis & Commentary, Nov. 5). How about not having any people around to buy any of their drugs any time for an incentive?

Bill St. George Jr.
Ocala, Fla.

SEEKING AN END TO QWEST'S STOCK SLIDE

As a stockholder and former employee of Qwest Communications, I've been following the fallout, innuendo, name-calling, etc., ever since Morgan Stanley & Co. first questioned Qwest's accounting practices back in June ("On the firing line at Qwest," Information Technology, Oct. 29). Since then, I've sat by nervously and watched the value of my Qwest holdings spiral down nearly 75% caused, in part, by Morgan Stanley's "gleanings" and the ensuing proposed litigation.

David M. Helmen
South Bend, Ind.

NOT ALL AGENCIES ARE THE SAME

"A debt trap for the unwary" (Finance, Oct. 29) failed to draw a distinction between accredited and nonaccredited counseling agencies. Springboard and other accredited agencies are members of the National Foundation for Credit Counseling and are accredited by the Council on Accreditation of Services for Families & Children. This sanction and its accompanying regulations guarantee that we will adhere to high standards of service delivery, counselor certification, fiscal integrity, and volunteer board governance.

Dianne Wilkman
President and CEO
Springboard
Riverside, Calif.

THE COMING WAVE OF SATELLITE-DIRECTED AIRCRAFT

Efforts to commercialize aircraft landing systems based on global positioning system technology are more widespread and faster-paced than Geoff Smith's report reveals ("Coming soon: Jets that land themselves," Developments to Watch, Oct. 22).

In addition to the Raytheon effort mentioned, Honeywell is leading a government-industry team, which has stalled prototype GPS precision approach systems at 18 civil airports. The Federal Aviation Administration, Boeing, Continental Airlines, and FedEx have flown hundreds of demonstration approaches using these systems. The FAA plans to have such systems ready for commercial use at major U.S. airports in 2004.

Ed Wheeler
Vice-President
Honeywell Airport Systems
Redmond, Wa.

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FORGETTING
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RACKING AN SSASSIN OF MEMORY

In the mid-1800s, few American intellectuals were more revered than Ralph Waldo Emerson. The philosopher was the bright center of a group that included Henry David Thoreau and Mary Wadsworth Longfellow. One of his famous essays, written when he was in his 50s, was on the subject of memory. "Without it, all life and thought are an unrelated succession. As gravity is a matter from flying into space, so memory gives stability to knowledge.... It tells us to our family, to our friends. It tells us why a home is possible; hereby only we find what has value."

Amazingly, within 20 years of writing these sentences, Emerson himself had few powers of memory left. He did not recognize his closest friends and could not understand what he read or follow a conversation. He had all the hallmarks of the disease that had not yet been named but had plagued mankind throughout history: Alzheimer's. His illness of aging illustrates the theme of Emerson's essay. For Alzheimer's slowly and relentlessly destroys not only memories but all the cognitive processes by which people define themselves. And thanks to longer life spans in Western countries, the incidence of Alzheimer's is dramatically rising—bringing both social and economic burdens. Currently about 5 million people in the U.S. have Alzheimer's, and the cost of their care is \$114.4 billion annually. Because some 20 million people over the age of 85 develop the disease, the Alzheimer's Assn. predicts that, based on projected life expectancies, there will be 12 million sufferers nationwide by 2050.

There are plenty of books and other resources aimed at helping caregivers cope with the disease. Journalist David Shenk's contribution is more literary in nature. *The Forgetting* is a quirky mix of medical history, the voices of patients

and their families, and accounts of the search for a cure. It includes case histories of such probable past victims as Emerson and Jonathan Swift, as well as current sufferers, such as former President Ronald Reagan. The book's structure is far from linear, but somehow, it works. Shenk makes the science understandable and recounts personal stories that are both moving and illuminating.

The disease was first identified in 1906 by a German doctor, Alois Alzheimer. Performing an autopsy on a female patient who died in her 50s after a long bout of dementia, the doctor discovered that the patient's brain was riddled with crusty brown clumps and weedy fibers. "Here was the evidence that [the patient] had not lost herself," writes Shenk. "Rather, her 'self' was taken from her." Scientists have since learned that these plaques and tangles, as they are called, are made up of a sticky protein that slowly strangles the brain. The first line of attack is the region of the mind associated with short-term memory. But as the protein accumulates, the patient loses more and more knowledge and slowly regresses to an infant-like state, which ends in death. Interestingly, the social skill that lingers the longest is manners—many caregivers note that their charges may not know who they are, but still say "please" and "thank you." These common courtesies are some of the first lessons drilled into a child's memory and are thus among the last memories to be destroyed.

As he delves into the science, Shenk gives a fascinating account of what memories are made of. He tells the story of a Harvard University-trained neurosurgeon, William Beecher Scoville, who in 1953 removed a section of the hippocampus from a 27-year-old man

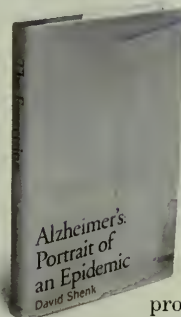
who had suffered from violent seizures since childhood. The operation eliminated the seizures but produced a grisly side effect—the patient could never again form new memories. For the rest of his long life, he could not learn a new face, name, or fact. The case revolutionized the study of the mind by revealing the role of the hippocampus in consolidating immediate thoughts into long-term memories. It also shed new light on Alzheimer's because its victims exhibit a similar form of the same problem. Scientists realized that when a patient can't locate his or her car keys, it's not so much that a memory has been lost as that it was never formed in the first place.

Shenk's exploration of the science of memory is the most satisfying part of the book. Far less so is his breathless account of the race for a cure. He details the many meetings of Alzheimer's researchers, the breakthroughs in understanding how the plaques are formed, and the debate between two different camps over whether these plaques are the cause of the disease or a symptom. But his overly dramatic telling occludes the fact that therapeutic progress has been incremental at best. The most promising new drug—a vaccine that has cleared away plaques in mice—is years away from being proven effective in humans.

In the end, it is Shenk's interviews with patients and caregivers that stand out. The voices of people recently diagnosed—and their struggles to maintain their dignity—are heartbreaking. The most moving story is that of Morris Friedell, a college professor in Santa Barbara, Calif., who was diagnosed with Alzheimer's when he was 59. Friedell is carefully chronicling his decline in the hope that it might help researchers. He is also trying to prove that rehabilitation is possible, at least in the early stages of the disease. Friedell has even presented posters explaining his research at scientific meetings. But he writes that in the last of Shenk's many conversations with the professor, a year after their first encounter, Friedell "asked me if we'd ever spoken before today."

BY CATHERINE ARNST

Senior Writer Arnst covers medicine.



A VIVID LOOK AT THE SCIENCE OF ALZHEIMER'S AND THE EXPERIENCES OF THOSE TOUCHED BY IT



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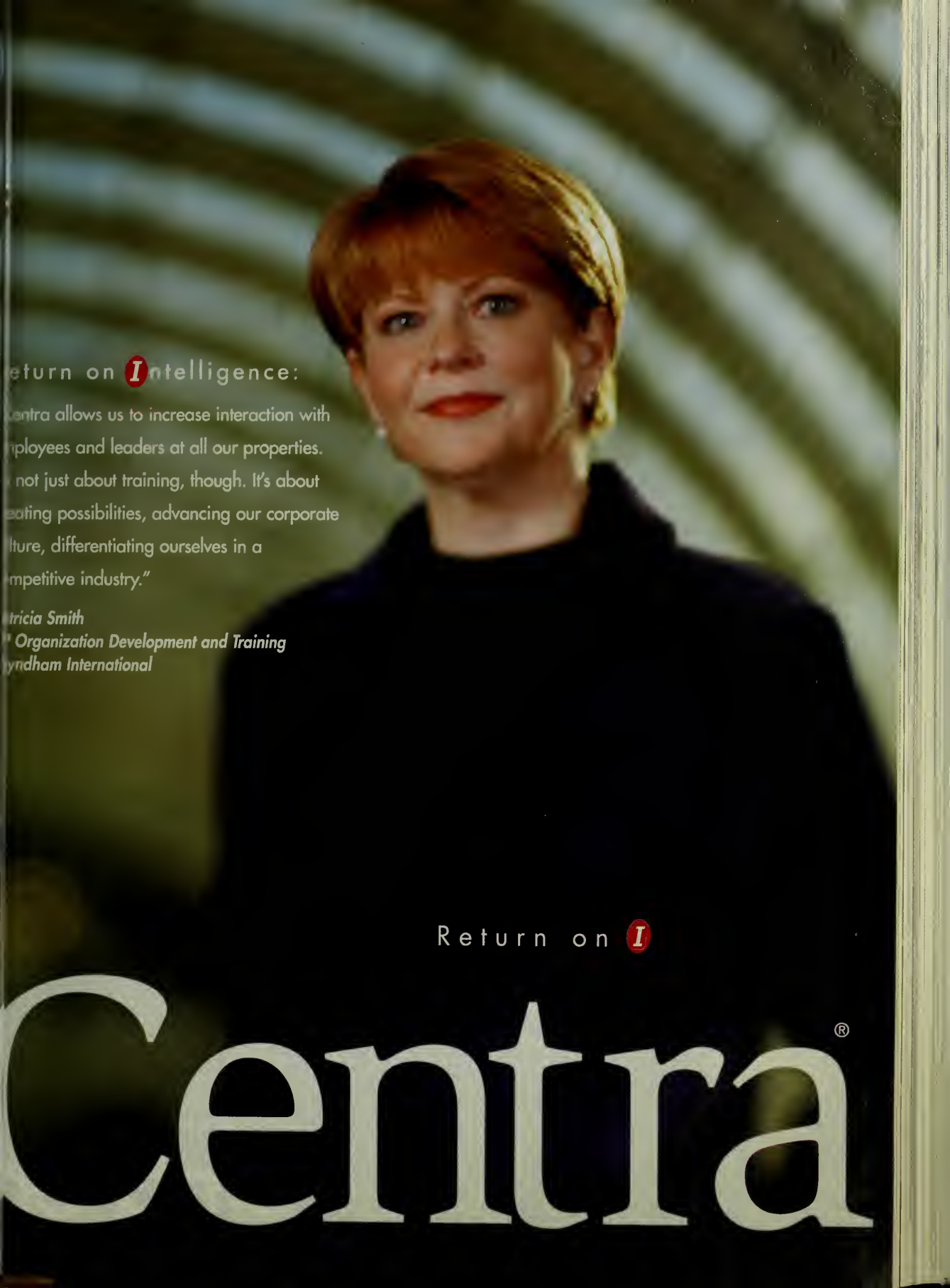
*Mark Hedley, SVP Chief Technology Officer
Wyndham International*

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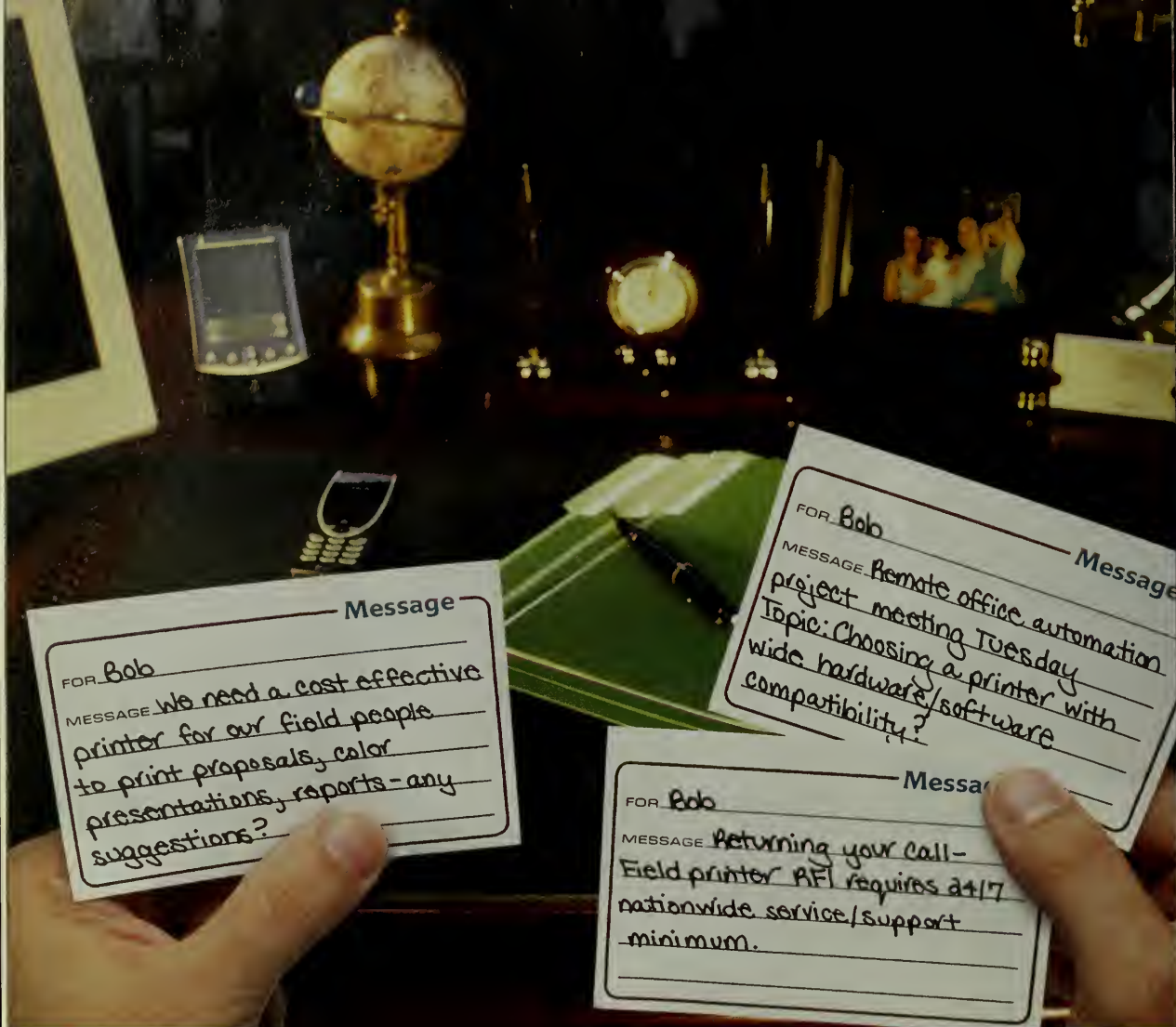
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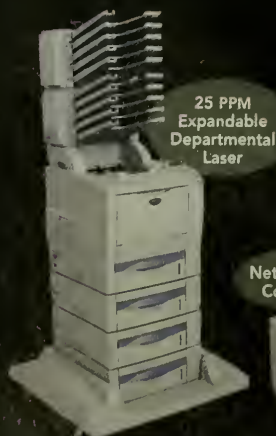
Patricia Smith
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MICROSOFT: THE BATTLE ISN'T OVER



ere's room
strengthen
e pact by
rring future
monopolies in
eas outside
e desktop

The Justice Dept.'s proposed settlement of its long-running antitrust case against Microsoft has come in for a tremendous amount of well-deserved criticism. Unfortunately, much of the griping has focused on the government's failure to put stronger locks on the doors of stables from which the horses have long since bolted.

It is true that the agreement would do little or nothing to prevent a repetition of Microsoft's domination of the browser market through integration with Windows. It's also irrelevant, because the fight for the desktop is over. Microsoft won, perhaps unfairly—but irreversibly.

That said, the agreement can be strengthened, either in renewed negotiations or in litigation carried on by the nine states that have refused to endorse the deal. I would make sure that any additional remedies prevented future anticompetitive behavior by Microsoft in fields where it will count. That means barring the company from leveraging its desktop monopoly into dominance of such growth areas as networking, including home networking, and Web services, such as Microsoft's own .NET initiative and competing services from Sun Microsystems, IBM, and others.

Microsoft has not been shy about trying to gain that leverage. With Windows 2000 and Office 2000, it achieved tight integration between workstations and corporate server computers. With Windows and Office XP, the integration is extended to Web servers that provide .NET services. For now, this is limited to such things as notifying you of the arrival of new messages in your Hotmail inbox. In time, however, these Web services could drastically change online commerce and the exchange of information in business.

In theory, independent software developers are free to take advantage of this integration, but they need details on how it works. The proposed agreement does nothing to assure them of the access they need to applications programming

interfaces (APIs) and communications protocols, which provide the links to other programs and to networks. The agreement requires Microsoft to provide the links as late as the last major test release of new versions of Windows or key components, such as the Internet Explorer browser.

This would be too little, too late. By the time of the "last major beta test release," Microsoft's own developers will have been working with the new code for months. Outside developers should get access at the time of the first external test release—typically six months to a year earlier. That's when Microsoft's own programmers and favored independent developers get the code.

KEEPING MUM. Equally important is assuring that the information Microsoft gives developers is complete and accurate. Independent developers have long complained that Microsoft provides incomplete documentation of the interfaces. And they charge that in its own applications Microsoft uses APIs that only it knows about.

Making sure disclosure is complete is an enforcement issue, and here, too, the agreement falls short. Microsoft compliance is to be monitored by a technical committee made up of three members: the first chosen by Microsoft, the second by the government, and the third by Microsoft and the government. The rules forbid membership to people who have done work for Microsoft or its competitors and prohibit them from doing such work for two years after leaving. This effectively bars service

by anyone with current commercial software experience, which is to Microsoft's advantage.

Judge Colleen Kottarakotely has the final word on the appointments. But as Microsoft showed in its fierce and ultimately successful battle to block the appointment of Lawrence Lessig, a law professor then at Harvard University and now at Stanford University, as an adviser to Judge Thomas Penfield Jackson in an earlier case, the company will do everything it can to get a committee that

favors its cause. The judge would be better served by appointing a traditional special master with the knowledge, resources, and power to make sure the terms are enforced fairly and strictly. He or she should be allowed to consult with developers at Microsoft's rivals.

These modest changes won't change the agreement into the tough settlement Microsoft's critics want, but that is no longer in the cards. The improvements would at least help make sure that the concessions that the government has won are meaningful as we move to the next generation of software.



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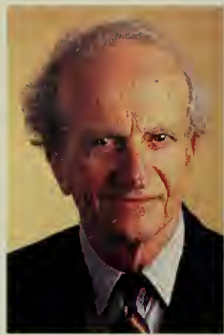
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BY GARY S. BECKER

THE AIRLINE BAILOUT SETS A BAD PRECEDENT



MISTAKE:
Market forces would have led carriers to tighten security and shave waiting time to lure back passengers

The airline industry was in trouble even before September 11, and it has become sicker since then. But that's not a good enough reason for generous government subsidies or federal help for other industries hurt by the recession and the terrorist attacks.

By early September, high fuel prices and a decline in travelers had already lowered airline profits and pushed some companies toward bankruptcy. The sharp drop in air travel after the 11th severely worsened these already bad short-term trends. Prices of airline stocks fell by over 40% from Sept. 10 to the close of markets on the 17th, and they have not recovered.

Airlines used the attacks as justification for large federal subsidies, and Congress responded. A board of federal officials, headed by Federal Reserve Governor Edward Gramlich, has been authorized to dole out \$10 billion in government-backed loans. Some \$5 billion more is available in outright grants, and half of this amount has already been distributed to many airlines.

This assistance, with perhaps more to follow, is unwise because stockholders, creditors, employees, and suppliers should have to bear most of the costs of the economic slump and the aftermath of the hijackings.

WHO ELSE? Airlines might well be compensated for their losses while airports were forced to close for a few days after the attacks. And both the Senate and House bills properly give airlines protection against liability claims that will result from these hijackings. But instead of greater subsidies, it would be much better for the economy to loosen some regulations, including restrictions on cross-border airline mergers and on foreign airline operations within the U.S.

Federal aid to airlines sets a bad precedent for other industries that are also suffering from the recession and consequences of the attack. Insurers, hotels, and others have asked for government support, and the case for helping them is no weaker than the one for subsidizing airlines.

To be sure, without public assistance, several airlines probably would have failed and entered into bankruptcy proceedings, and so might some hotel chains and insurance companies. But the stronger ones would continue to operate while in Chapter 11, and they would shed debt and gain greater financial strength. Subsidies mainly delay their adjustment to reduced travel and other effects of greater concerns over safety. Moreover, propping up weaker companies hurts the strong ones, since they then have to cope with subsidized competitors. National and international

market forces are much more efficient at determining who survives and in what form than government officials subject to pressures from constituents and industry lobbyists.

The Federal government should be responsible for setting and monitoring tough security standards at all airports, but financing and implementation ought to be left to airports and airlines. Security is a cost of travel that should ultimately be borne by passengers, just as they pay for pilots, planes, and fuel.

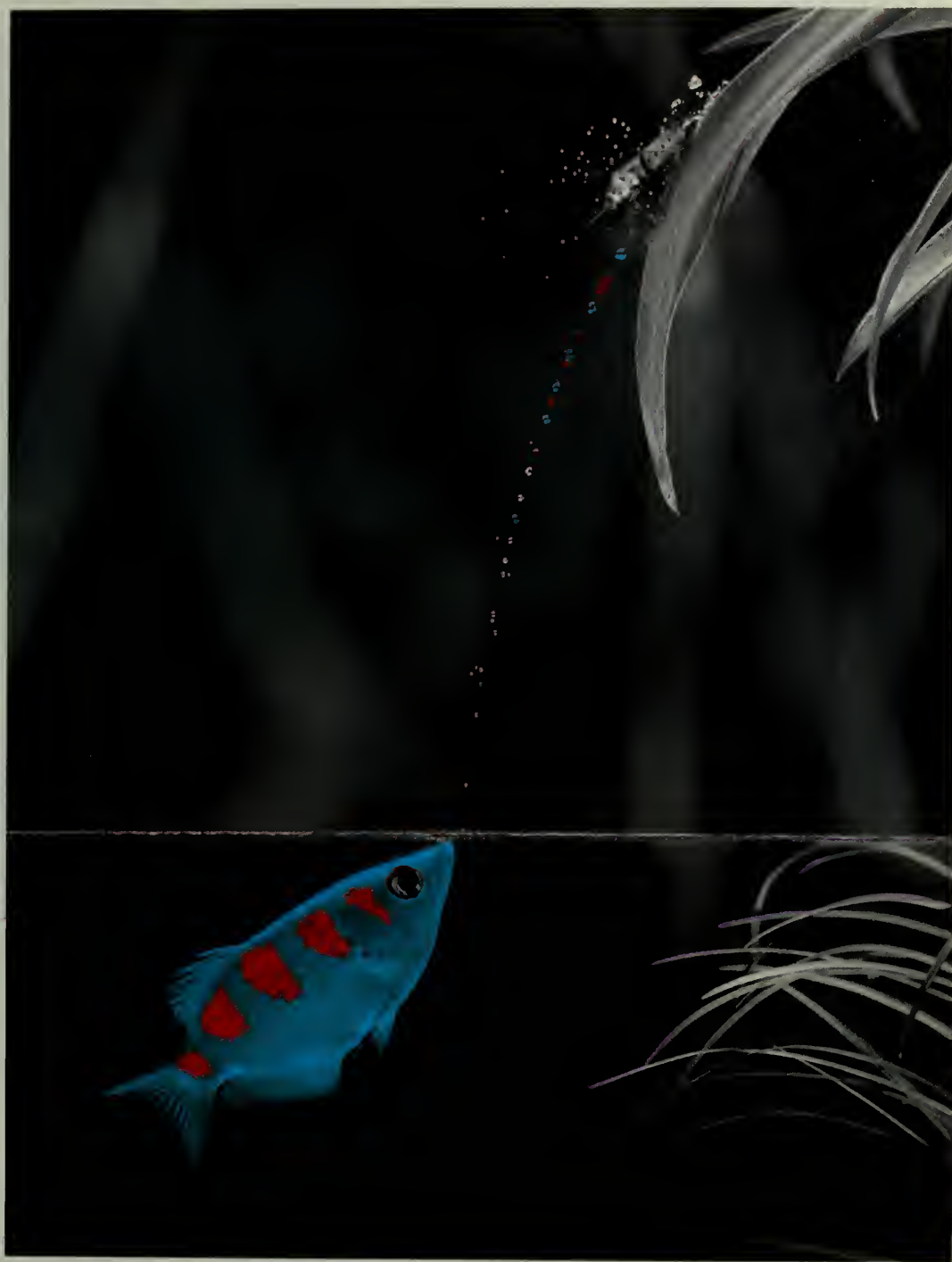
WHAT CUSTOMERS WANT. Heightened security while checking in and gaining access to departure lounges inevitably leads to some increase in waiting time at airports. The cost of such waiting time does not show up on any company's balance sheet, but it can become a major deterrent to flying. Since there are about 800 million passenger flight segments each year on U.S. airlines, an additional hour, or even 30 minutes, of delay in each segment is likely to considerably reduce the demand for air travel.

If airlines are responsible for security, they have to hire additional security employees, add checkpoints, and introduce other changes to prevent unnecessary increases in waiting due to improved airport security. Airlines already take account of the value of time when they provide quicker check-ins to first-class and frequent flier whose time is deemed more valuable. The House Aviation Security Bill anticipates that a surcharge of under \$3 on each flight segment would be enough to pay for upgraded security. Most passengers would pay more than twice that to reduce lines by 30 minutes.

Democrats in Congress and others argue that private personnel cannot guarantee adequate airport security and that the government should run security with federal officers. Yet El Al at many European airports with much tighter security than American airports mainly use private security companies. But I fear that public managers of American airport security would consider extended waits at airports an inevitable cost of travel, just as long lines at gas stations during the 1970s was attributed to the high price of oil, even though it was caused by government rationing of gasoline.

The attacks on September 11 were terrible enough without becoming a shield for increased federal spending on politically powerful industries. The hasty bailout of airlines should not be compounded by further assistance to this industry or by subsidies to the many other industries who await their turn at the public spigot.

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.



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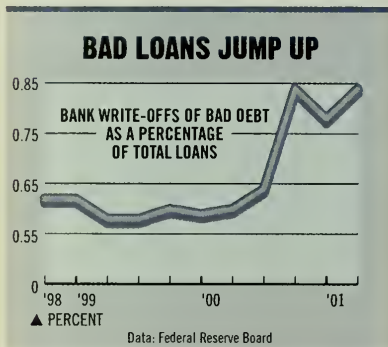
Microsoft

EDITED BY MICHAEL J. MANDEL

ARE BANKS READY FOR DEADBEATS?

Reserves may be inadequate

The way banks deal with the possibility of bad loans is to set aside a pool of money, called the "loan loss reserve." As recession looms, how much banks increase reserves depends on how bad they think the downturn will be and how many debtors may have trouble repaying their loans.



In the last recession, banks were pounded because they underestimated the risks they were taking. Now a new study of 38 large banks from UBS Warburg's equity research team suggests that once again, many banks have been too optimistic and set aside too few reserves to deal with the likely prospect of soaring defaults and slow payments. That could mean a big hit to earnings starting with the fourth quarter.

The problem is that banks have an incentive to under-serve, because additions to the reserve pool come out of net income. So far, in 2001, most banks have kept reserves at 2000 levels, say analysts at UBS Warburg, despite the worsening economy and rising rates of charge-offs, which represent the cost of loans that have actually gone sour. The hope was to avoid an unnecessary hit to net income if things got better in the second half of 2001.

That's a risky policy now that recession has become a reality and reserves are draining faster. Even before September 11, charge-offs of bad loans had risen by 40% from the second quarter of 2000 to the second quarter of 2001 (chart). Given rising unemployment, further increases are inevitable. Indeed, in the 1990-91 recession, charge-offs peaked after the downturn ended.

The UBS analysts estimated that seven large banks—with outstanding loans totaling more than \$800 billion—need to boost their reserves by a combined 40% to deal with the likelihood of a sharp deterioration in their loan portfolios. Such a move would shave \$6.4 billion from pretax bank earnings.

To be sure, the shortfall in reserves doesn't mean banks are financially unsound. "I don't think it's a crisis—banks are definitely better capitalized than they were at the beginning of the 1990s," says Michael A. Plodwick, an executive director of research at UBS Warburg and author of the report. Nevertheless, banks are again showing their reluctance to face up quickly to bad news.

By Margaret Popper

COLLEGE-TOWN CONFIDENTIAL

Higher ed is no economic panacea

In the knowledge-based New Economy, it's often suggested that state and local government support for higher education can be an important tool for economic development. The assumption is that expanding local colleges and universities to produce more college graduates creates a better-educated local workforce, which will attract more high-skilled jobs. The leading examples of the effect are often said to be Boston and San Francisco, where the presence of strong universities appears to be a cornerstone of the local economy. Skeptics, though, have argued that college-educated workers are quite mobile, not closely tied to their alma mater at all.

A new study by economist John Bound of the University of Michigan and three co-authors finds there is a relationship between degree production and the concentration of college-educated workers in a state's population in the long run—but it's not anywhere near as large as economic-development officials might want. Based on four decades of Census data and figures on degrees awarded by state, the study reported that "states awarding relatively large numbers of BA degrees...have somewhat higher concentrations of college-educated workers." However, the link is relatively weak—increasing the output of college graduates in a state by 10%, say, has a much smaller effect on the education level of the state workforce, as grads move away to find jobs. Such mobility reduces the economic incentive for states to invest in higher education.

INFLATION FEARS MAY BE INFLATED

Why prices are likely to stay low

How low can inflation go? While the latest government reports show negligible price increases, some economists fear an inflationary backlash around the U.S. economy finally turns around. Near-zero real interest rates, they argue, will spur rapid growth and fuel a period of rising prices.

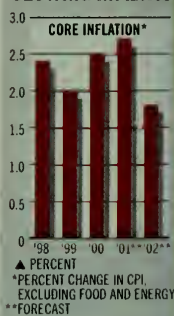
But James E. Glassman, senior U.S. economist at J.P. Morgan Chase & Co., argues the combination of weak demand, excess capacity, and falling energy prices should hold consumer inflation below 2%—perhaps even lower—through at least 2002. Core inflation, which excludes food and energy, could fall to 1.8% next year, predicts Glassman. That would be the lowest level since 1965.

The main reason for the fall in inflation, in Glassman's view, is that the U.S. economy is operating well below potential. For example, U.S. plant utilization is at only 75.5% of capacity for September, and Glassman expects it to sink to 74% by next summer. Moreover, the capital investment boom of the late '90s has left many other countries with large amounts of unneeded capacity as well, making it even harder to increase prices. And energy prices are already dropping: Gasoline, for example, has fallen to an average retail price of \$1.21 a gallon, from \$1.71 in May. Besides helping consumers at the pump, lower energy costs could hold down the prices of goods and services. "Reduced cost pressures on nonenergy businesses could subtract as much as 0.5% from next year's [consumer price index]," says Glassman.

Even if the U.S. economy were to suddenly catch fire again, rampant inflation is not likely to reemerge. Glassman argues that the long-term potential growth rate is 3%-4%, so the economy would have to grow significantly faster than that to use up excess capacity. In fact, by his calculation, the U.S. would have to grow at 9% over the next year to create an inflationary rebound.

By James Mehrhoff

SLOWING INFLATION





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WHAT'S NOT DEFLATION AHEAD, JUST SLOWER INFLATION

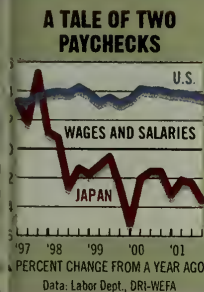
Thanks to a mild recession, prices could rise just 1% or 2% in 2002

U.S. ECONOMY

Prices are falling. Commodities are 12% cheaper than they were two months ago. Imports costs are dropping like a stone. Producer prices in October took the largest e-month dive on record. Sounds like it's time to worry about deflation, right?

Wrong. First of all, let's get straight what deflation is, and what it isn't. Deflation is a broad and lasting decline in the overall level of prices caused by a period of severely weak demand. Price drops in a few select goods, such as oil or computer equipment, is not deflation. Nor is it a slowdown in the growth of the price index. That's disinflation.

Instead, deflation works like inflation in reverse, a wage-price spiral that heads downward. Falling prices create expectations of further price declines, which cause people to delay making purchases. With demand weak, unemployment soars, causing wages to fall in tandem with prices. The real cost of borrowing rises, even when market interest rates fall to zero, so few companies want to borrow for new projects.



Household spending has stagnated, forcing companies to cut prices further to bring in business. Consumer prices, down 0.8% from a year ago, have been falling since 1999. Even with market interest rates at zero, few in Japan want to borrow or invest.

THE U.S., nothing so pernicious is in the works right now. Nor will it be in 2002, because this year's aggressively stimulative policies will turn around demand before U.S. spending becomes so weak that wages begin to shrink across a broad swath of workers, as has occurred in Japan (chart). Consumer prices in the U.S. are up 2.6% over the 12 months ended in September, and wages have increased more than 4%.

To be sure, inflation is set to decline in the coming

year, and wage growth will slow. That always happens in a recession. However, recent drops in the price indexes have more to do with transitory effects after the September 11 attacks and the ongoing strength in the dollar than with fears that demand is collapsing.

Indeed, retail sales rebounded with surprising strength in October. Incentive-driven car sales led the phenomenal 7.1% spending surge, but nonauto buying bounced back solidly as well. Excluding the 26.4% jump in car sales and the 6.4% drop in gasoline receipts caused by falling prices, retail sales recouped all of their September losses (chart).

As a result, consumer spending is shaping up to be much less of a drag on the economy in the fourth quarter than economists had expected, even if car sales fall back to more normal levels. The apparent mildness of the recession is the best argument against deflation.

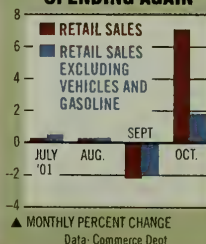
SO WHY THE LATEST FLURRY of deflation stories?

The media attention was triggered by recent price reports showing a drop in prices. First, the third-quarter gross domestic product data showed that prices paid by consumers for goods and services fell at a 0.4% annual rate from the second quarter. That was the largest quarterly drop in nearly five decades.

What went largely unnoticed, though, was that all of that drop occurred in September, when overall prices were dragged down from August by a sharp adjustment to insurance premiums after the September 11 tragedies. The Commerce Dept. subtracted the benefits paid out from premium expenses, making it appear as if consumers paid less for the same insurance coverage. The result was a record 1.4% drop in overall service prices from August to September. This measure of service prices has declined only once before in the postwar era, and the September falloff will not be repeated.

Then came the October producer price index, which plummeted 1.6%—also a record monthly decline. But, here again, all of the drop reflected blips that won't affect future months. The post-September 11 plunge in oil prices sent wholesale prices for gasoline and heating oil down more than 20%, and Detroit's sales incentives

CONSUMERS ARE SPENDING AGAIN



resulted in a 4.7% drop in car prices. Those two factors accounted for all of the month's plunge.

More important, the PPI covers mostly domestically made goods. Prices for those items are very sensitive to changes in global demand and to the price competition from cheap imports stemming from a strong dollar. As in 1998, when world demand sagged in the wake of the Asian crisis, the huge price drops in commodities and imports are fueling the deflation story (chart).

Also, bear in mind that goods prices don't tell you anything about the trend in service prices—58% of the overall consumer price index. Excluding the volatile ups and downs of energy and food, inflation for consumer goods has fallen to zero this autumn, but service inflation is running at more than 3.5%. Service inflation during the past year has been rising, not slowing, fueled mainly by faster growth in costs for health care and education.

CURRENT DEFLATION FEARS also ignore a crucial part of any price outlook: The link between wages and prices is just as important to deflation as it is to inflation. Wages must fall outright before deflation can truly be said to have taken hold of an economy.

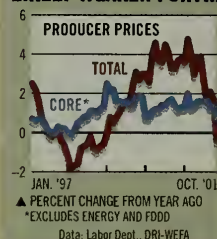
Undoubtedly, wage growth will slow in the coming year as the unemployment rate rises. That's what happened following the 1990-91 recession. Back then, the jobless rate rose from just over 5% to almost 8%, and

wage growth slowed from 4% to about 2.5%—a rate that prevailed for most of 1992 and 1993. But, again, pay didn't shrink, pay raises just got smaller.

A similar pattern is very likely to occur in 2002, as businesses strive for productivity gains in an effort to cut unit costs and restore profit margins. But since the jobless rate is unlikely to hit 8% next year, wage growth may not fall to as low as the 2.5% pace of the early 1990s. Moreover, 85% of the workers on private payrolls do not work in areas that produce domestically made goods. So the effect of today's falling goods prices on overall wages in the economy is too weak to breed broad deflationary conditions.

While deflation is an insidious disease, slowing inflation will be a plus for the economy. Right now, inflation as measured by the CPI is running at just over 2.5%. In 2002, the rate could easily fall into the 1%-2% range, leaving room for both profits and household buying power to grow, even in a sluggish economy. So put your deflation worries away. Instead, focus on the coming benefits of price stability, the holy grail sought by most central bankers and something the economy has not enjoyed since the 1960s.

GOODS PRICES WILL LIKELY WEAKEN FURTHER



CANADA

UH-OH. THE LOONY IS LOOKING LIMP

The Canadian dollar's rapid deterioration is crimping the Bank of Canada's stimulus plan.

The dollar, nicknamed the loony, sunk to a record low of 62.3¢ U.S. on Nov. 9, a large drop of 5% since June (chart). The loony enjoyed a rally on Nov. 13, but it will be short-lived. Traders are pushing down the loony because of falling prices for commodities, lower interest rates, and weak stock prices.

The currency's fall comes as Canada wrestles with signs of a recession. Unemployment in October edged up to 7.3%, a two-year high. The October purchasing managers' index rebounded from September's 45.4%, but last month's reading of 48.5% suggests

that the industrial sector is in a recession. And business sentiment continued to fall. After the September 11 attacks on the U.S., security measures at border crossings are delaying the movement of goods and adding to company costs.

Nonetheless, the BOC sounded cautiously optimistic in its November *Monetary Policy Report*. The report estimated that real gross domestic product probably fell by as much as a 1% annual rate in the third quarter and that growth in this quarter will be flat. But in 2002, the MPR said, real GDP will likely grow 1.5%. Slower growth will bring down inflation, probably to "well below" 2% next year.

The BOC has already cut interest rates eight times this year, including a surprisingly large three-quarter-point reduction on Oct. 23. Analysts expect another cut at the Nov. 27 meeting. But the BOC will be flying solo in its policy efforts, since the budget plan expected in December is likely to propose limited fiscal stimulus.

Lower short-term rates, however, mean more erosion in the dollar. And while that may help make manufactured exports more attractive, it will do little for major Canadian exports, like oil and commodities that are mostly priced in U.S. dollars. Plus, the pronounced weakening in the loony will hurt investor interest in Canadian securities. That will raise long-term rates, hurt Toronto's equity markets, and delay the recovery.

THE CANADIAN DOLLAR HITS A RECORD LOW





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A wide-angle aerial photograph of San Francisco, showing the dense urban landscape from the hills down to the water. The Transamerica Pyramid is a prominent landmark in the skyline. In the foreground, a grassy hillside slopes down towards the city, with several small red flags planted in the ground.

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AFGHANISTAN

THE RUSH OF VICTORY

As the Taliban topples, America is scrambling to foster political stability and bring in the U.N.

With a speed that stunned members of the anti-terror coalition, Northern Alliance rebels in Afghanistan are capturing the country's key cities only a week into a U.S.-backed ground offensive. The decision of the Taliban militia to turn tail has once again shifted the political and military equation in the campaign against terrorist leader Osama bin Laden and his Taliban protectors. Now, with the Taliban fleeing to the mountains, the U.S. and its allies must scramble to fill the political void in Kabul. Job No. 1: putting in place a transitional government that somehow transcends the nation's vicious ethnic and regional rivalries.

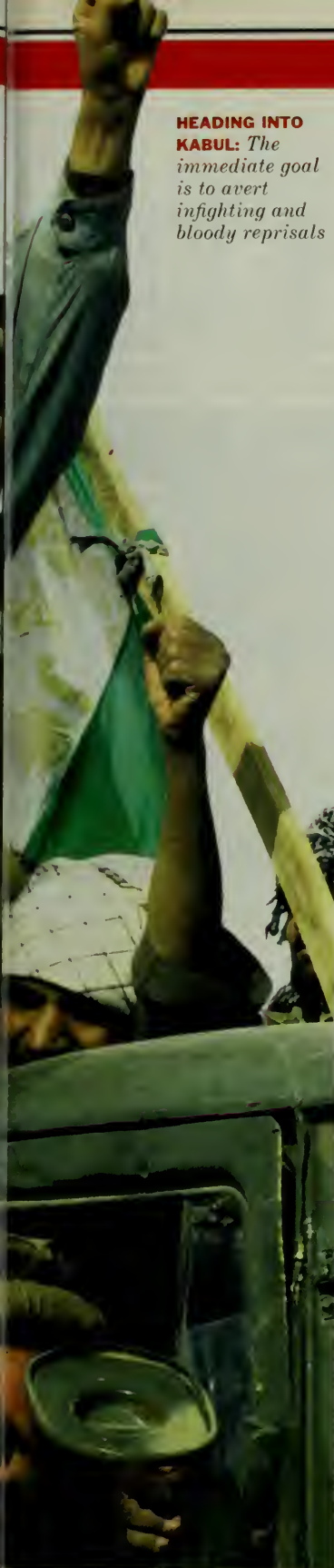
Of course, coping with a swifter-than-expected Taliban retreat is a pretty good problem to have. Just a few weeks ago, the White House faced worries that the war was bogging down. But those fears greatly underestimated the toll of heavy bombing by U.S. B-52s, the ability of mobile Northern Alliance rebels to take advantage of U.S. tactical air cover—and, of course, the

THE CHALLENGES AHEAD

COALITION-CRAFTING

U.S. attempts to forge a post-Taliban government under U.N. auspices need to go faster. The problem: Getting Pashtun leaders in the south to negotiate with the largely Tajik and Uzbek Northern Alliance that now commands most of the country.





HEADING INTO KABUL: *The immediate goal is to avert infighting and bloody reprisals*

Taliban's snap decision that a cold winter in the mountains beats suffering heavy casualties in Afghan cities.

Still, an enemy that lurks in mountainous redoubts shouldn't be discounted, which is one reason allied war planners aren't celebrating too loudly. "These tactics of withdrawal are not new," warns Vladimir Solovyov, who was a colonel during Russia's disastrous Afghan war. "Now, a new stage of partisan warfare will begin."

That is undoubtedly true. Yet by abandoning the conventional battlefield to the rebels, Taliban leader Mullah Omar has created a huge opening for his foes, from giving the coalition air fields to ferry in aid to providing new staging areas for the search for al Qaeda's leaders. Now that the Northern Alliance controls much of the country, the U.S. has to make sure that the machinery of war doesn't outpace the painstaking diplomatic drive needed to create a new Kabul government that is stable—or what passes for stable in Afghanistan.

POWER SHUFFLE. The diplomatic challenge for the U.S. will initially focus on attempts to broaden oversight of the country from the largely Tajik and Uzbek Northern Alliance to Pashtun leaders in the South. Although the Bush team has had limited success so far in developing allies in the south, it hopes that key Pashtun commanders, such as Hamid Karzai, will react to the Taliban rout by angling for a spot in a new ruling coalition. Washington also hopes for defections from Taliban fighters in the south, though so far, few have occurred. Says Michael E. O'Hanlon, a Brookings Institution analyst: "We have to give them reason to think they'll benefit" from a new regime.

But even if a Pashtun shift occurs, there are other potentially explosive political issues facing the allies. Among them: fears that the Taliban's defeat will destabilize Pakistan and doubts that any post-Taliban regime will be able to stave off infighting, bloody reprisals, and even a government collapse.

The Administration is devoting most of

its diplomatic energy to crafting a broad ruling coalition under U.N. auspices—a task that isn't made any easier by the macho pronouncements of rebel leaders. Already, ex-Afghani President Burhanuddin Rabbani, who was due to return home on Nov. 15, has declared that there will be no role for Taliban elements in a national reconstruction government.

Meantime, reports of Northern Alliance atrocities are complicating the reconciliation process. Alliance commanders have old scores to settle with the Taliban and a record of human-rights abuses. Fears that bloodletting could spread weren't helped by images of rebel executions of captured Taliban prisoners.

The Northern Alliance is seeking a power-sharing deal under the titular

THE WAR ON TERRORISM

leadership of exiled King Mohammed Zahir Shah. In the U.S. view, the elderly Shah can serve a useful role as the focal point for returning Afghan dissidents. The King will be "a postage-stamp figure," says Stephen P. Cohen, a former State Dept. policy planner now at the Brookings Institution. "But there's a better-than-even chance of creating a government." Why? Because "for the first time in history, everybody agrees on the kind of government Afghanistan should have."

But if that is the outcome outsiders would like to see, getting there won't be simple. The White House thinks it's essential that the U.N. oversee the process in order to counter perceptions that Washington controls the chessboard. "The U.N. is the most credible vehicle," says Deepa M. Ollapally, a South Asia specialist at the U.S. Institute of Peace. That's why U.N. Secretary General Kofi Annan, with the support of Afghanistan's neighbors, hopes to set up a provisional government that includes all ethnic Afghan factions and could draft a new constitution.

Because suspicions about the Northern Alliance run high, the U.N. envisions a multinational force to maintain order. One U.S.-backed idea calls for contingents to be drawn from such Islamic nations as Turkey, Indonesia, and Bangladesh, plus Jordan. But Britain

PAKISTAN'S DILEMMA

The absence of Taliban representatives in a new Afghani reconstruction government could provoke explosive unrest at home for Pakistani ruler Musharraf. To temper any backlash, Musharraf is calling for an all-Islamic peacekeeping force for Afghanistan.

HUMANITARIAN RELIEF

With winter coming and hundreds of thousands of Afghan refugees huddled in makeshift camps, allies are under pressure to step up relief efforts. The U.S. may be able to use liberated air bases to begin supplying food and medicine to civilians.

and France also hope to enlist. Pakistani President Pervez Musharraf is agitating to join as well, but the U.S. demurs, noting that the pro-Taliban Pakistani army would hardly be seen as impartial.

Musharraf's standing at home is already shaky as a result of large numbers of Pakistanis sympathetic to the Taliban. The General is facing fierce fire from army hardliners and Islamic leaders for throwing in his lot with the Americans. Now, he faces a new threat:

R.K. Ramazani, an Iran expert and former University of Virginia scholar. According to Defense Secretary Donald H. Rumsfeld, the anti-terror war has the potential to create "new relationships... all across the globe."

The early success on the ground also holds out the prospect of reversing the perception, spread by bin Laden and his propagandists, that the West is waging a crusade against Islam itself. The U.S. now has the opportunity to launch a truly effective mission to aid war-bat-

has two carrier battle groups in the gion, 1,000 ship-based commandos, and the 10th Mountain division based in Uzbekistan. Says Rumsfeld: "Our first priority is unquestionably tracking down the leadership [of] al Qaeda and the Taliban."

After absorbing an early bloody defeat at the hands of the Northern Alliance, the Taliban remains a force to be reckoned with—but one that's weakened and may at some point become more receptive to U.S. appeals to give up

REBUILDING AFGHANISTAN: KEY PLAYERS



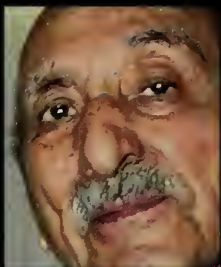
PAKISTAN'S MUSHARRAF

First he must mollify angry elements at home



THE U.N.'S ANNAN

Ready to move swiftly to control the chess board



FORMER KING ZAHIR SHAH

The rallying point of a unity government?



EX-PRESIDENT RABBANI

He is said to oppose a role for the Taliban



PASHTUN LEADER KARZAI

Will he have a place at the post-Taliban table?

reports that fleeing Taliban fighters are streaming across Pakistan's border. "That's a nightmare scenario," says Rifaat Hussain, a military expert at Islamabad University. The Taliban "could use the border as a sanctuary to create a mini-Afghanistan in the Pashtun belt."

Since many Pashtuns are clustered in Peshawar and points north, the Taliban's setbacks could stoke calls for Musharraf's ouster. A typical dart comes from Imran Khan, a centrist Islamic political leader: "What is Pakistan going to be left with now? [Musharraf] kept talking about a broad-based government and now look what we've got—the Northern Alliance in Kabul."

As dicey as things look in Islamabad, the rout of the Taliban could produce some immediate payoffs for the U.S. and its allies. Iran, which has been gingerly weighing a thaw with the West, is offering to rescue downed allied pilots in its territory and is permitting food convoys to go through Iran en route to Afghanistan. Ayatollah Ali Khamenei, the nation's powerful conservative cleric, has called for a counter-jihad against bin Laden-style terrorists. "I'm more optimistic [about improved relations] than I have been in a long time," says

tered Afghan civilians. With much of the country under Northern Alliance control, the U.S. can use newly liberated airfields to bring in food, medicine, and fuel. Already, barges are bringing in relief supplies from Uzbekistan. Ground-based aid stations could be far more efficient than the current practice of dropping dried meal packets from C-17 transport planes.

PEACE POLICY. Seizing the moment, President Bush will also attempt to defuse Islamic anger by launching a new Middle East peace initiative. The Administration will soon go public with a renewed push to halt violence in the region and lay the groundwork for the creation of a Palestinian state.

But while much of the action has shifted to political and diplomatic fronts, that doesn't mean the Afghan war is over. Fighting will grind on—and could intensify. Indeed, the sudden change in Taliban tactics may hasten the need for a significant U.S.-British ground assault on suspected bin Laden hideouts—one involving thousands of troops rather than handfuls of Special Forces commandos. London has just put thousands of soldiers on alert and has 238 Royal Marines in the area. The U.S.

Laden and put an end to allied pounding.

True, that doesn't look likely today. But then again, who would have anticipated a few weeks ago scenes of newly clean-shaven Afghans rejoicing in the streets of Kabul? "Events acquire their own momentum," says Eli A. Cohen, a military strategist at the Johns Hopkins School of Advanced International Studies. "It's one of the lessons of all this."

The other, as George W. Bush is wont to remind us, is that today's quick and relatively easy victories are meaningless until the ultimate objective is reached. For America, that still means decapitating entrenched terror networks in Afghanistan and beyond.

Ironically, it also means a prolonged bout of "nation-building" and multilateral coalition-tending for a President who came to power scornful of such pursuits. But that was before September 11, the day that Bush's mind—and his mission—changed forever.

By Lee Walczak, Stan Crook, and Paul Magnusson, with Lorraine Woelber in Washington, and with Frederik Bakfour in Islamabad, Catherine Belton in Moscow, Naween Mangi in New York, and bureau reports

A HARD SLOG FOR FINANCIAL 'SPECIAL FORCES'

Treasury's money warriors are finding the battle is all uphill

Like the ground war, the fight against terrorists' money is entering a new phase. A sweeping crackdown on two financial networks allegedly linked to Osama bin Laden and al Qaeda—including raids in American cities on Nov. 7—capped the initial campaign on the financial front. Treasury Dept. officials say that so far they have netted \$56 billion in assets and bank accounts from the 10 individuals, charities, and businesses they have accused of aiding terror. "We're mending the bridges of bin Laden's financial enemies," says a top Treasury official.

IMP TEAMS. But that is just the beginning. Now, the U.S. financial warriors are following an audit trail for terrorist money" laid out in records seized from those targets, especially bin Laden, al Qaeda and al Qaeda networks of banks, money transmitters, and trading firms, says a senior U.S. official. The Treasury, the FBI, and the Federal Reserve have assembled "jump teams" of accounting, banking, and criminal investigators ready to fly abroad to squeeze evidence of new linkages from the records. "We have our own Special Forces," says the official. In the past week after the al Qaeda raids, no such teams were dispatched—and more are being readied. But even as the U.S. widens the financial front, it faces steep hurdles at



TERROR TROVE "You can't track every \$1,000 transaction," says one expert

home and abroad. U.S. banks are growing restive under investigators' barrage of requests for data. Their enforcement systems—designed to detect huge transfers by drug traffickers and other money launderers—are poorly suited to ferreting out the small, routine transactions of terrorist cells. "A good-size bank has 1 million to 5 million ATM transactions a day, 10,000 to 100,000 wire transfers. What do you look for in all

that?" asks the security chief at a major regional bank. Privately, bankers fret that Treasury's freeze orders will put them on the hook for lawsuits and worry that Americans may balk at higher costs and greater scrutiny of their financial lives.

And abroad, too, the money warriors are fighting uphill. While the Bush Administration has won unprecedented international cooperation, foreign law enforcement agencies and courts are starting to ask for stronger evidence to back up Washington's asset freezes. The requests will turn into demands if, as financial sources suggest, Treasury's next list of businesses targeted for seizures includes foreign banks that U.S. investigators believe cooperate with al Qaeda.

LATE START. Treasury officials say better tools and communication between probers and bankers will overcome the objections. Catching terrorists "is not something you're going to do by looking at the haystack of financial transactions," says Treasury Secretary Paul H. O'Neill. "It comes from intelligence" that provides banks and allies with targeted accounts to watch.

In Washington, at least, the financial war is raising cooperation to new heights. The decision to raid al Qaeda's worldwide operations, for example, drew in agencies from the CIA to the IRS. But it took weeks

THE WAR ON TERRORISM



MOGADISHU A probe at Barakaat headquarters

TERRORIST MONEY: THE BALANCE SHEET

Assessing the U.S. campaign to choke off Osama bin Laden's finances

Data: BusinessWeek

THE MONEY TRAIL

PROS The U.S. and other countries have frozen \$1 billion allegedly owned by Osama bin Laden, the Taliban, the al Qaeda network, and businesses and charities that back al Qaeda.

CONS U.S. and foreign agencies are ill-equipped to ferret out small transfers and routine transactions of active terrorists or hijackers. Operations underway.

for such coordination to reach the front lines. The Securities & Exchange Commission didn't give brokers and mutual funds its first "control list" of suspects, whose accounts should be watched, until Nov. 5. And local police say they're being frozen out: Police Chief Michael Chitwood of Portland, Me., says his force and the FBI were both investigating two men eventually linked to al Barakaat, but the feds won't share information.

Financial institutions are struggling to

overhaul money-laundering controls for new duties. Terrorist money is hard to catch because many transactions—car rentals, hotel rooms, and small wire transfers—"fall below the radar screen," says Ellen Zimiles, a partner at KPMG's forensics practice. "You can't track every \$1,000 transaction that passes by."

The raids on al Barakaat revealed another weakness. U.S. banks, from Key Bank to Chase Manhattan, routinely wired al Barakaat's funds from

the U.S. to Dubai without realizing it was operating as a *hawala*—a Middle Eastern remittance system unregulated by the federal government and poorly overseen by states. "U.S. banks are clueless about *hawala* and parallel banking"—ways to move money without using banks—says Patrick Jost, former Treasury financial investigator who is now a security consultant at SRA International. U.S.-based money transfer companies such as Western

WESTERN UNION: WHERE THE MONEY IS—IN SMALL BILLS

In the three days preceding September 11, four separate payments were sent to the United Arab Emirates by the alleged hijackers. All four were made through Western Union Financial Services Inc. agents in the U.S., according to law enforcement officials.

On Sept. 8 and 9, Mohamed Atta, who the FBI says was on American Airlines Flight 11 that crashed into the World Trade Center, wired a total of \$4,000 from two Maryland locations to Mustafa Muhammad Ahmed, a top official in Osama bin Laden's organization—apparently returning excess funds. On Sept. 9, Waleed M. Alsheri, who was also on Flight 11, sent \$5,000 to Ahmed from Boston's Logan International Airport. And on Sept. 10, Marwan Al Shehhi, who was on United Airlines Flight 175, sent \$5,400 to him. A year ago, the suspected hijackers received money by at least two other transfers through Western Union, government officials said.

It is unclear whether Western Union realized the significance of the transactions until the FBI began its investigations. But money-laundering experts say transfers totaling

nearly \$15,000 to one person over three days is a red flag. "Anything over \$4,000, within one month alone, should get flagged," says Jorge Guerrero, president of the National Money Transmitters Assn. trade group. Western Union would not comment on the transfers or whether they had triggered an internal investigation, but said it is cooperating

fully with the government. "Until an individual winds up on a list, we're going to be able to stop those transactions," says spokesman David B.

The pre-September 11 payments aren't Western Union's only encounters with suspected terrorists. At least one of its 50 UAE agents operates out of al Baraka Exchange storefront. The Treasury Dept.'s Office of Foreign

Assets Control has identified al Qaeda as part of the al Barakaat network of banks and companies, which charges is involved in raising money by moving funds for al Qaeda.

SPEED AND ANONYMITY. Money transfer shops have grown exponentially in the past decade, fueling legions of immigrants who send home. About \$40 billion is transferred annually through the Western Union, says *The Nilgiri*, a California newsletter. Western Union, by far the largest, did 89 million transfers last year. The appeal to clients is obvious: cash moves around the world in little as 15 minutes. No bank account or background check is necessary. Nor is an ID to send less

TERRORISTS' TRANSFERS

In the three days before their September 11 attacks, three terrorists wired money through various Western Union agencies to Mustafa Muhammad Ahmed, a top official in Osama bin Laden's organization

MOHAMED ATTA

\$2,000

Mail Boxes Etc., Laurel, Md.

\$2,000

Giant Supermarket, Laurel, Md.

WALEED M. ALSHERI

\$5,000

Logan Airport, Boston

MARWAN AL SHEHHI

\$5,400

Boston bus station

Data: Law enforcement agencies

NATIONAL COOPERATION

20 countries including privacy havens as Iceland, Liechtenstein, Bahamas, and the United Emirates, have blocked of suspect groups.

as the U.S. w's list of suspects foreign banks and governments are edging more evidence to seizures of funds.

NEW TOOLS

PATRIOT ACT gives Treasury stronger tools to stop cash imports, block assets during investigations, and cut off foreign banks that don't cooperate in probes.

COWS Banks fear a grab bag of anti-money-laundering proposals will boost costs and erode privacy without stopping terrorists' transactions.

nion also need tighter controls. Banking executives insist that they're not even thinking about the cost of stricter enforcement—although it's adding up. A large bank typically spends \$10 million a year to fight money-laundering, says KPMG's Zimiles. The search for terror money is boosting their tab—and adding new costs for brokers, insurers, and money-transfer businesses. Most of the battles on the fi-

Controls on recipients vary. In the UAE, the limit is \$5,000 until the government raises it to \$550 on Sept. 27. Money-transfer systems' very speed and anonymity make it attractive to terrorists, drug dealers, and others. "If I give you a million dollars, I can move it through Western Union inside of a week and it would be totally untraceable," says Lyle, former director of special operations at Western Union. Using money transfers and paying others to do the work for them would be enough to beat a search, he says. Before leaving the company in 1997, when his job was terminated, he helped develop Western Union's network in Latin America. "When we set up branches in Mexico, Peru, and the Dominican Republic, business took off like you would expect. A lot of those guys picking up money between the U.S. and Colombia were standing outside the offices with bodyguards and guns under their arms. It was pretty obvious what was going on," he says. William Thomas, president of Western Union's international unit, calls Justus' claims "irresponsible, false and unfortunate." However, Western Union may be vulnerable because of its phenomenal growth. In 1995, when it was bought by

financial front will be fought abroad. The U.S. has rallied 120 nations to block assets of suspected terrorist groups. The latest raids even enlisted support from such staunch supporters of bank privacy as Liechtenstein and the United Arab Emirates.

The cooperation goes beyond terror money: Several

small tax-haven nations will soon sign information-exchange treaties that will help the U.S. catch tax dodgers, says Treasury's O'Neill. But he wants to go further. "We need nations all over the world identifying from their own intelligence nominees for blocking," he says.

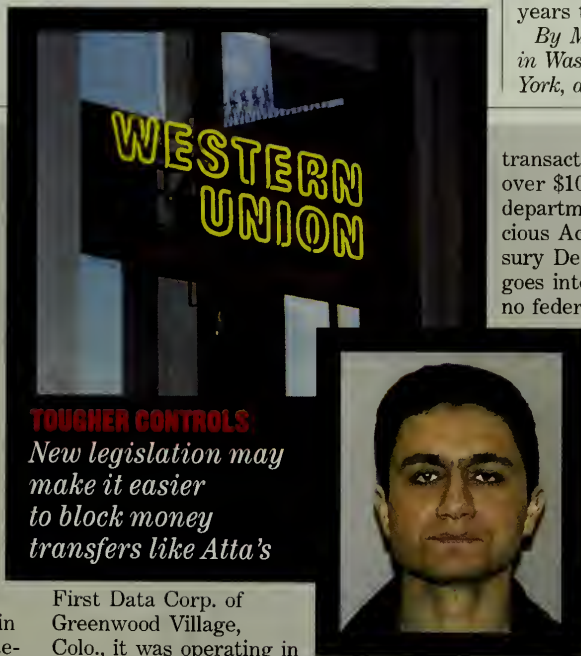
Some nations, however, haven't been

so responsive. Sweden referred the Treasury's request to freeze al Barakaat assets to the Stockholm police—and they're still investigating. And a British court has ruled that a Saudi businessman can challenge a U.S.-requested freeze on his accounts.

HIDDEN DAMAGE. Unlike troops in Afghanistan, money warriors can't always tell how much damage they've done to the enemy. Treasury officials suspect they've snipped only a few strands of al Qaeda's financial web and will need to move against dozens, if not hundreds, more businesses, charities, *hawala* offices, and banks. Even then, the cost of terrorism is so low that a smuggled suitcase of cash could fund another attack.

So even as the financial front broadens and deepens, no one in the top ranks is predicting victory yet. Americans are likely to live with the war's costs—in limitations on their financial privacy, in friction in doing business—for years to come.

By Mike McNamee, with Amy Borrus, in Washington, Heather Timmons in New York, and David Fairlamb in Frankfurt



TOUGHER CONTROLS
New legislation may make it easier to block money transfers like Atta's

First Data Corp. of Greenwood Village, Colo., it was operating in 20 countries. It expanded by forming affiliations with local firms such as Al Baraka, and now has more than 117,000 agents in 187 countries. It controls about three-quarters of the market. In 2000, Western Union's revenue grew nearly 20%, to \$1.8 billion, while operating profits rose 17%, to \$540 million—about half of First Data's overall profits. **RADICAL CHANGES.** Money-transfer agents have long tried to allay fears they are a hotbed of money laundering. They must get identification for every

transaction over \$3,000, report those over \$10,000 to their state banking department, and voluntarily file Suspicious Activity Reports to the Treasury Dept. But until new legislation goes into effect in January, they have no federal regulator. The Patriot Act, aimed at tracking and stopping terrorist money, should bring some radical changes. "The money-transfer business was caught in the crosshairs," says Donald Vangel, who is a partner with Ernst & Young. "They're going to have to beef up their controls."

On the ground, little seems to have changed yet. The teller at a Western Union desk in a Manhattan

grocery store says the company is still operating the way it did before September 11. Western Union says it is continually reviewing its procedures.

U.S. government officials have pointed to the *hawala* system, which is used to transfer cash in the Middle East, as a possible conduit for terrorist money. That may be so. But, for now, America's own homegrown money transfer system apparently can easily be made to serve the same purpose.

By Heather Timmons in New York



RIYADH High unemployment is contributing to mounting discontent and religious extremism

SAUDI ARABIA

A TEST FOR THE HOUSE OF SAUD

Can it keep the lid on in the face of huge social and economic pressures?

Scenesc from Saudi Arabia, post-September 11: In an airy but modest house in the Saudi capital of Riyadh, a member of the royal family turns to the problems dogging the Kingdom and much of the Arab world. Relations with the U.S. are badly frayed. Unemployment is alarmingly high. There is mounting discontent and religious extremism. "We worry," says this royal, a man known for reformist

leanings. "If there is no improvement in conditions, this will hurt us three, four, five, or seven years down the line."

Elsewhere in Riyadh, a group of bankers, lawyers, and other business leaders gather inside a walled compound. Over dinner, talk turns to the overt hostility of many Americans, who are enraged that 15 of 19 terrorists were Saudis. "I am afraid my grandchildren will never enjoy the freedom of the U.S.

the way my generation has," says the host, Sheikh Omran Al-Omran, former chairman of Riyadh Bank. Hundreds of Saudis studying in the U.S. have come home, fearful of harassment in America.

Meanwhile, in an academic's office, a moderate Islamist offers a Westerner what seems a surprising admission about the impact of Osama bin Laden's attacks on Saudis. "I don't know a married woman, or child who was not happy

SAUDI ARABIA'S ECONOMIC CRUNCH

STAGNANT ECONOMIC GROWTH...

REAL GDP GROWTH



...IS PUTTING PRESSURE ON LIVING STANDARDS...

PER CAPITA GDP



...AS OIL PRICES SLIDE

SAUDI OIL PRICE



Data: U.S. Embassy, Riyadh; Saudi American Bank

out what happened in the U.S.," says Abdullah Al-Sabeh, a professor of psychology at Riyadh's Imam Mohammed bin Saud Islamic University.

ISING ANGER. Throughout the Kingdom, Saudis at all levels of society are beginning to wonder if something fundamental has changed in their relationship with America. For some, the enormity of the September 11 attacks is beginning to sink in. "It was a shock to Saudis that Saudis undertook such aberrant activities," says Prince Turki Al-Faisal, former chief of Saudi intelligence. In the wake of the attacks, two certainties that formed the bedrock of Saudi society have been shaken. One is the idea that the U.S.-Saudi alliance will remain in place, a tie forged on the evils of money and power whose dynamics will never change. The other is the conviction that the House of Saud would always, with a deft mix of ruthlessness and popular appeal, control its destiny and that of the Kingdom.

These certainties have given way to a

daunting list of questions from both Saudis and Americans. Will the U.S.-Saudi relationship, scarred by events of September 11 and inflamed by passions on both sides, ever be the same? Can Saudi society, under huge social and economic pressures, remain stable—or is it simply set to blow, with incalculable consequences for the Mideast, the global economy, and the U.S.? Will the House of Saud survive?

The answers may depend on one 78-year-old man, Crown Prince Abdullah, who rules Saudi Arabia in the name of his invalid brother, King Fahd. Despite his age, the Crown Prince is a reformer determined to save his house by dampening corruption and opening the economy to more competition and investment. He's also determined to lessen dependence on the nation's powerful U.S. ally.

Abdullah's actions on the diplomatic front have raised hackles in American quarters, even though the Bush Administration says it is happy with the cooperation it's getting from the Saudis. Abdullah knows that anger at the U.S. is rising across the land. That's because the masses can now view the daily clashes between Palestinians and Israelis on satellite TV from Qatar or read

about them on Internet sites that reopen under new names as fast as the government shuts them down. The fundamentalist religious Establishment preaches constantly against the Israelis. Abdullah reflects that anger. In an unusual series of letters and phone calls to President George W. Bush, the Crown Prince pleaded for more American activism on the Palestinian question. In a follow-up visit to Bush, Prince Saud Al-Faisal, the Saudi foreign minister, has urged him to take quicker action.

Abdullah has offered limited cooperation with the U.S. after the September attacks. The Saudis did act behind the scenes. They severed relations with the Taliban and pledged support for Pakistani President Pervez Musharraf. They instructed local banks to scour their records for traces of individuals or organizations named by the U.S. as suspected of funding terrorist organizations. Saudi American Bank says it has 42 people on the case.

THE WAR ON TERRORISM

Yet the House of Saud is caught between its American ally and public opinion in the Kingdom, which, it fears, is running dangerously in favor of bin Laden. So Abdullah never made the big gesture that would have gone down well with the American public—and persuaded the Saudis of the horror of the terrorist attacks. "Abdullah should have quickly assembled a party of top leaders and gone to the U.S. to express their condolences," says a Saudi banker in Riyadh. Americans wonder what the Saudis are holding back. "They have not been fully

supportive," says Eliot A. Cohen, a national security expert at Johns Hopkins University's Paul H. Nitze School of Advanced International Studies. "The conversations [between the U.S. and the Saudis] may be tougher than they have been in the past."

HIGH UNEMPLOYMENT. As Abdullah holds those conversations, he will have to have some tough exchanges with the royal family, too. Their legitimacy is also on the line. Ordinary Saudis believe that the family has wasted the Kingdom's vast wealth through mismanagement and corruption, and that no one has taken them to task. So Abdullah has instituted a family council to

try to discipline family members, and reduced military spending to dry up the opportunity for corruption there.

But the fight against corruption is just one part of Abdullah's struggle. Thanks to the recent oil boom, Saudi Arabia has built up reserves of \$90 billion, but that doesn't solve the systemic problems. Per-capita gross domestic product has fallen to just one-fourth of its peak of \$28,600 in 1980 (charts). Oil and oil products still



REFORMER
Crown Prince
Abdullah

account for at least 90% of Saudi exports, 75% of government revenues, and close to 40% of GDP. Manufacturing outside of petrochemicals accounts for less than 10% of GDP. Although oil prices are in decline now, the Saudis are hoping that they and other OPEC members can keep them high enough to tide the economy over until structural reforms bear fruit.

One scourge worries the House of Saud above all—unemployment. "You don't want to see people on the street. In the long run, it creates instability,"

says Prince Mohammed K. A. Al-Faisal, the 34-year-old vice-president of the Al Faisaliah Group, a family company. Each day, shiftless young men gather on the outskirts of Riyadh, smoking water pipes and drinking coffee. They have all the time in the world to get angry at the system.

This powder keg wasn't always there. Twenty years ago, just about any Saudi could find a comfortable position, and access to the universities was easy.



CUSHION Soaring oil prices piled up \$90 billion in reserves

Now, huge population pressures are overwhelming the schools and, ultimately, the job market. Joblessness is estimated at 15% and rising. Companies are just not creating enough jobs, despite intense pressure to hire Saudis instead of South Asians and other expatriates. This move toward so-called Saudization is the bane of Saudi bosses, who say foreigners are better skilled, and more reliable than locals. "The Saudi wants to be well-paid to do nothing," says a Saudi manager who asked not to be named. Meanwhile, about 150,000 young Saudis enter the workforce each year. Some 50,000 find work. "I don't see any data to suggest Saudi Arabia has turned the corner on creating jobs," says Brad Bourland, chief economist at Saudi American Bank, a Citigroup affiliate in Riyadh.

Observers worry that fallout from the attacks could scare off investment in areas like telecommunications and tourism. Since a new investment law was passed 18 months ago, some \$10 billion in foreign projects had been approved. "This momentum will certainly be slowed," predicts Bourland. For now, the biggest foreign investment project is

still on track. ExxonMobil, Royal/Dutch Shell Group, and BP are still hoping to finalize deals worth up to \$25 billion to exploit Saudi gas reserves.

Putting money into people's pockets would certainly help quiet discontent. But it's not the full answer. While the world will probably never know why so many Saudis participated in the September hijackings, the rapid social change of the past five decades certainly played its part. "We don't feel good in

our identity as Saudis," says Omar Al-Modayfer, a psychiatrist and liberal Islamist, adding that attempted suicides are rising. "Saudis are caught between what I call Americanization and their own values. They have no way to adjust." Al-Modayfer and other observers say that Saudi Arabia is short on sports programs, recreational activities, and other tools that modern societies use to engage young people.

Some Saudi analysts say that the top leadership either doesn't get this message, or if it does, doesn't know what to do. The royal family includes thousands of members, surrounded by tens of thousands of retainers. "They want to change, but when you don't have a feedback mechanism you are stuck," says one Saudi professional.

Abdullah could still try to give citizens more of a stake in the country's decision-making. But many of the House of Saud and their supporters say that democracy would be a disaster in the Kingdom. Saudi Arabia, they argue, is a patchwork of tribes that are held together by the royal family. Elections would rekindle ancient rivalries. "We would have a Yugo-

slavia here," says one businessman.

Maybe, but restricting dissent as the government does has its costs, too. The lack of public debate helps what even many fundamentalists consider warped ideas about Islam to take root. For instance, Sheikh Abdulaziz Al-Qasem, former judge, says the notion that America's support of Israel justifies *had*—holy war—on the U.S. does not wash under Islamic law. Yet many people across the region endorse it. "Unless people can debate freely, extremist opinion will rise," he says.

"EVOLUTION, NOT REVOLUTION." The frustration is mounting. At a recent gathering in Riyadh, a dozen Saudi professionals and executives expressed a wide range of gripes. A professor says his students were so poorly prepared for higher education that they were hopeless. A business manager said he doubted his children would find the same opportunities that he did. There was much discussion of corruption, although some thought the U.S. should have used its influence to help curb it.

Is this the kind of malaise that feeds revolution? Not yet. "Ninety percent of the people would like to see the House of Saud change—not have them [removed]," says an engineer and moderate Islamist from Bureida, a hotbed of religious fundamentalism north of Riyadh. Outside observers wonder what the pressures will produce. "In the long run, I can't see the system surviving as it stands," says Fareed Mohamedi, chief economist at energy consultants Petroleum Finance Co. in Washington, D.C. He predicts "evolution, not revolution."

And if Abdullah is to press ahead, he needs time and perhaps luck. A breakthrough in the Mideast peace process, for example, could restore the warmth of the U.S.-Saudi alliance, and give the regime a new legitimacy. "If we solve the Palestinian problem, what other issues are there between us?" says Al-dulrahman Al-Zamil, chairman of Al-Zamil Group, a petrochemicals conglomerate with about \$1 billion in annual revenue.

Meanwhile, Abdullah seems to be looking for ways to finesse the contradictions that face his country. His watchwords: Tinker with sensitive institutions. Don't tear them up root and branch. "When faced with problems, we look at all the ramifications," says Al-Faisal, the former intelligence chief. "That has been a mainstay of the Kingdom." Whether that approach fits the realities of the world after September 11 remains an open and frightening question.

By Stanley Reed in Riyadh



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September 11th
James Browning Wyeth

AMERICA THE BEAUTIFUL

*O beautiful for spacious skies,
For amber waves of grain,
For purple mountain majesties
Above the fruited plain!
America! America!
God shed his grace on thee
And crown thy good with brotherhood
From sea to shining sea!*

*O beautiful for pilgrim feet
Whose stern impassioned stress
A thoroughfare for freedom beat
Across the wilderness!
America! America!
God mend thine ev'ry flaw,
Confirm the soul in self-control,
Thy liberty in law!*

***O beautiful for heroes proved
In liberating strife.
Who more than self their country loved
And mercy more than life!
America! America!
May God thy gold refine
Till all success be nobleness
And every gain divine!***

*O beautiful for patriot dream
That sees beyond the years
Thine alabaster cities gleam,
Undimmed by human tears!
America! America!
God shed his grace on thee,
And crown thy good with brotherhood
From sea to shining sea!*

*O beautiful for halcyon skies,
For amber waves of grain,
For purple mountain majesties
Above the enameled plain!
America! America!
God shed his grace on thee
Till souls wax fair as earth and air
And music-hearted sea!*

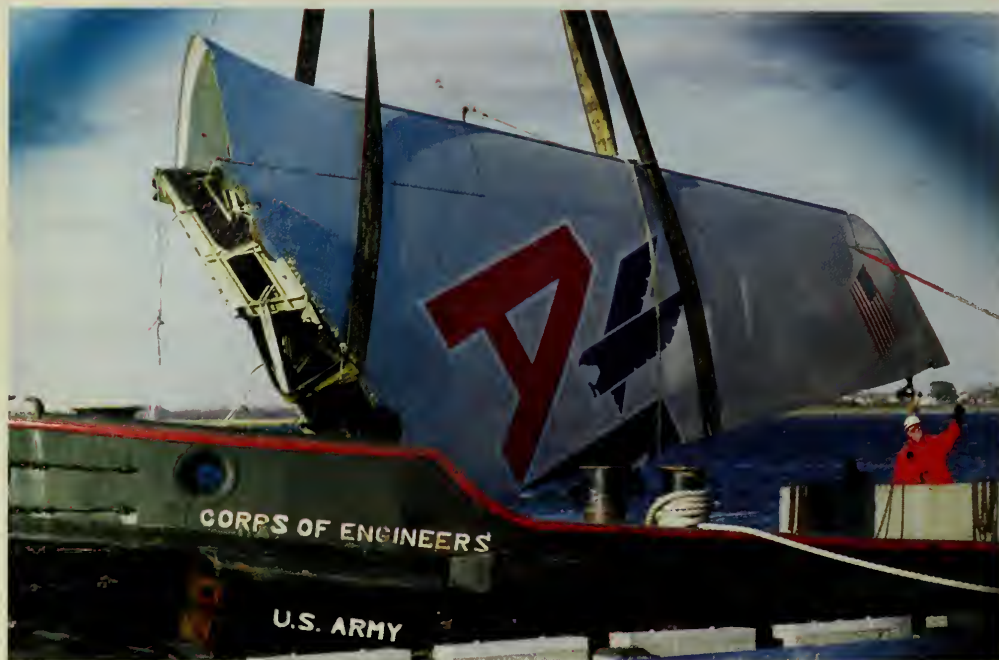
*O beautiful for pilgrims feet,
Whose stem impassioned stress
A thoroughfare for freedom beat
Across the wilderness!
America! America!
God shed his grace on thee
Till paths be wrought through wilds of thought
By pilgrim foot and knee!*

*O beautiful for glory-tale
Of liberating strife
When once and twice, for man's avail
Men lavished precious life!
America! America!
God shed his grace on thee
Till selfish gain no longer stain
The banner of the free!*

*O beautiful for patriot dream
That sees beyond the years
Thine alabaster cities gleam
Undimmed by human tears!
America! America!
God shed his grace on thee
Till nobler men keep once again
Thy whiter jubilee!*

America the Beautiful
Katherine Lee Bates, 1893





FALLOUT: Some airlines may not last out the quarter

AIRLINES

THE CLOUDS KEEP GETTING THICKER

Flight 587 is another blow to carriers' darkening prospects

In this strange new world tainted by terrorism, bad news is relative. So airline executives breathed a rapid sigh of relief when the crash of American Airlines Inc.'s Flight 587 in New York on Nov. 12 appeared, at least from early reports, to be the result of a mechanical problem, not sabotage. "I never thought I'd use the words 'hopeful' and 'mechanical failure' in the same sentence," says Marianne McInerney, executive director of the National Business Travel Assn.

Yes, it could have been worse for an airline industry already reeling from the September 11 terrorist attacks. But that doesn't hide the fact that the outlook remains depressingly bleak for the airlines well into next year. And the American accident, which killed more than 260 people, is likely to further depress Thanksgiving and Christmas travel, typically the only bright spots in a normally weak quarter. **DOWNTIME:** Holiday travel will suffer

home for the holidays," says analyst Susan Donofrio of Deutsche Banc Alex. Brown. Until now, leisure traffic had been tepidly coming back since September 11, but only with deeply discounted fares. "Consumer confidence in our industry faces yet another speed bump to recovery," says William S. Swelbar, managing director at ECLAT Consulting. "The timing couldn't be worse."

The crash could add \$400 million to industrywide losses, says analyst Samuel Buttrick of UBS Warburg. That and the slow rebound in revenue even before the latest accident may result in overall losses of \$6.4 billion for the industry this year, up from Buttrick's previous forecast of \$5.6 billion. He's expecting Thanksgiving traffic to be down about 20% to 22% from the year before, with little immediate impact from the crash. Most tickets have already been bought and are non-refundable. But air travel at Christmas could fall another five percentage points beyond the 15% drop he had been expecting. "The airlines have a very big profit problem, which this crash exacerbates," says Buttrick. "But this crash isn't the big event."

AMERICAN'S PLIGHT. American, which lost two planes in the September 11 attacks, is likely to suffer more than its rivals. But analysts don't expect the impact on it to be long-lasting. That's

been the case in past airline accidents. Buttrick expects American to lose \$740 million in the fourth quarter, including up to \$100 million as a result of the Nov. 12 crash. But the damage could deepen if terrorism isn't ruled out and American is seen as a particular target because



its name. "That [would be] catastrophic for American," says consultant anley L. Pace of Bain & Co.

Another risk is that the latest accident plus fatal crashes on American in 1995 in Cali, Colombia, and Little Rock, Ark., could raise widespread doubts among travelers about its safety record. "I won't fly American because they've had too many crashes," says Edward C. Gray, a Charlotte Hall, Md., fireman who worries whether maintenance has been adequate.

For the rest of the industry, though, the biggest problem remains the fact that costs continue to outstrip revenues. And that's after carriers have slashed 10% of capacity and cut such amenities as meals and airport clubs. Analysts and airline managers are widely predicting a shakeout, mostly through bankruptcies and asset sales, not outright mergers. Helene Becker, an analyst at brokerage Buckingham Research Group, says some smaller players could fail within the next two months. And with a poor holiday period, some majors could falter in the first half of next year, even with the \$15 billion federal bailout passed after September 11.

DANGERED. America West, Southwest Airlines, and United Airlines top the list of most-endangered carriers, say many analysts. But the wild card is how the government will administer its \$10 billion federal loan-guarantee program. On Nov. 13, America West was the first to receive some \$400 million in loan guarantees, after winning \$600 million in concessions from aircraft leasing companies and vendors, contingent on the federal financing. "We feel very confident with these loan guarantees, we absolutely are the clear," says CEO Parker.

But many industry experts are hoping the loan board will avoid propping up carriers that might have been en route to bankruptcy even before September 11. "The real question is whether the government is going to use the loan-guarantee program to make sure no airlines fail. That would be unfortunate, because we have too much capacity," says economist Gary J. Dornan of National Economic Research Associates Inc. Analyst Becker agrees. The question for Congress and the administration is: Do they want a healthy, competitive industry, or do they want a lot of airlines?" she says. If blows like the Nov. 12 crash keep coming, they won't be getting either.

By Wendy Zellner in Dallas, with Michael Arndt in Chicago and bureau reports

NO JINGLE BELLS ON THESE REGISTERS

As early as August, retailers worried that it would be tough to get consumers in a festive mood for holiday shopping. But with the terrorist attacks casting a pall over the economy, many of them are bracing for a truly blue Christmas.

Indeed, despite the surprisingly strong October retail sales numbers released by the Commerce Dept. on Nov. 14—which showed sales surging 7.1% in October over September's depressed levels—many analysts remain worried. Most of the gains came as Detroit's zero-interest financing drove car sales up 26.4%; without autos, retail sales rose just 1%.

The upshot is that while shoppers

hand, could be big losers. Federated Department Stores Inc., for one, has already warned that fourth-quarter sales at stores open a year or more will be down 7% to 10%. Others feeling the heat include jewelers and high-end apparel retailers. Talbots Inc., which saw same-store sales drop 12.5% in October, is playing down party dresses in favor of basics such as sweaters. Meanwhile, jeweler Zale Corp. is hiring fewer holiday clerks and managing inventories more tightly.

With consumers sticking close to the hearth, purveyors of home furnishings, books, kitchen accessories, and toys hope to cash in on the public's sudden "nesting" in-



WALK ON BY: Sales look bleak

may still be willing to open their wallets for great, once-in-a-lifetime deals, that doesn't mean they'll be hanging out at the mall. Carl E. Steidtmann, chief economist for Deloitte Research, predicts retail sales for the November-to-January stretch will be flat compared with the same period last year. Only 9% of shoppers surveyed by Deloitte plan to boost spending this Christmas; 30% will spend less. That could spell trouble for retailers, who make up to half their profits during the holidays. "This will be one of the worst fourth quarters [for retailers] in the postwar period," says Steidtmann. **DISCOUNT POWER.** Still, the pain won't be evenly spread. Jupiter Media Metrix Inc. predicts that online retailers, who start from a much smaller base, could see holiday orders rise 11% over last year, to \$11.9 billion. Discounters such as Wal-Mart Stores, Target, and Kohl's will likely perform best among traditional retailers.

Department stores, on the other

hand, could be big losers. Federated Department Stores Inc., for one, has already warned that fourth-quarter sales at stores open a year or more will be down 7% to 10%. Others feeling the heat include jewelers and high-end apparel retailers. Talbots Inc., which saw same-store sales drop 12.5% in October, is playing down party dresses in favor of basics such as sweaters. Meanwhile, jeweler Zale Corp. is hiring fewer holiday clerks and managing inventories more tightly.

When consumers do splurge, it takes a sale to get them to open their wallets. Melinda Helveston, a Birmingham (Ala.) homemaker, didn't feel like shopping after September 11. But during a trip to Atlanta's tony Lenox Square Mall, she could not pass up a pair of Cole Haan shoes that were marked down at Rich's, a unit of Federated.

Of course, parents will still spend on their kids: Thanks to the release of Microsoft Corp.'s \$299 Xbox video game and Nintendo Co.'s GameCube console, Toys 'R' Us Inc. should do well. "This is going to be a peak year for video games," says Chief Executive John H. Eyer Jr. In this dismal season, however, that isn't saying much.

By Dean Foust in Atlanta, with Louise Lee in San Mateo, Calif.

SHOPPERS WON'T BE INDULGING



LEGAL AFFAIRS

MICROSOFT: NOT SO FAST, MR. GATES

California's attorney general wants a tougher settlement

It didn't take California Attorney General Bill Lockyer long to show his populist bent. Back in January, 1999, on his first day as the state's chief law enforcer, the 60-year-old liberal Democrat gave back the free parking spot that comes with the job, insisting that it be used by the office's employee of the month instead. To this day, Lockyer is considered one of the nation's fiercest consumer-rights advocates, battling alleged price gouging by oil companies, aggressive marketing from Big Tobacco, and false advertising by long-distance carriers.

Now, a new side of Lockyer is emerging: champion of some of Silicon Valley's most powerful tech companies in their epic struggle with Microsoft Corp. In the wake of Microsoft's settlement with the Justice Dept. and nine states, Lockyer is becoming the software giant's most potent nemesis. Backed by a powerful anti-Microsoft lobby in the Valley, he has criticized the proposed deal more sharply than any of the eight other attorneys general who are still suing the company. A source close to the states says that he is pushing for the harshest remedies.

His office is footing the bill for Brendan Sullivan, a top litigator hired to represent the nine holdout states. Lockyer has assigned six full-time staffers to the case—more than any of the other attorneys general. "I'm the people's lawyer, and this just isn't a very good agreement for them," he says, insisting that Silicon Valley lobbying has had no influence on his views.

Nor is it a good deal for Microsoft competitors, who plan one last push for a tougher settlement in advance of a looming court deadline. The dissident states have until

Dec. 7 to present their alternative-remedies proposal to U.S. District Judge Colleen Kollar-Kotelly. On Nov. 19, several attorneys general and staffers plan to meet in Washington, D.C., for a briefing on the alleged shortcomings of the deal presented by Microsoft opponents. Microsoft rivals also plan to lobby the

WHAT'S STILL ON THE TABLE

Nine states opposed to the Microsoft settlement have until Dec. 7 to submit an alternative-remedies proposal. Some ideas being considered:



LESS WIGGLE ROOM The holdout attorneys general will attempt to close potential loopholes in the deal the company reached with the Justice Dept.

MORE INFORMATION To enable other software makers to better integrate their products with Windows, the AGs may try to force Microsoft to provide rivals with more technical data than the settlement calls for

UNBUNDLED WINDOWS The AGs could try to force Microsoft to sell a version of Windows without some types of software, such as instant messaging and media players

states to seek a broader package of remedies, including new provisions that go beyond the scope of Justice's proposed settlement, says Washington attorney Glenn B. Manishin, who represents the Software & Information Industry Assn., a trade group that has opposed Microsoft.

Manishin says opponents are pushing a proposal, for example, that would force Microsoft to distribute archrival Sun Microsystems Inc.'s Java software in the Windows operating system. In its unanimous ruling, the D.C. Circuit Court of Appeals held that Microsoft took illegal steps to cripple Java technology. Another new idea would be requiring Microsoft to support open industry standards rather than forcing customers to use its own proprietary protocols.

TOUGH NEGOTIATIONS. According to the source close to the states, Lockyer "certainly is pushing for" those remedies. However, this source says, it is unclear whether the other states will go along with the proposals: "It's going to take some consensus" to get the other states to California's position; "It will be hard."

If Lockyer can't get the other attorneys general on board—especially Connecticut's Richard Blumenthal and Iowa's Tom Miller, who have both played bigger roles in the case—he's unlikely to win support for a stricter remedy package. But according to the same source,

SILICON ALLY: close to the state Lockyer is leading the revolt

there is one point that the holdout states are likely to agree on: provision that would require Microsoft to go further in disclosing its application-programming interfaces, or APIs, to independent software vendors than they would be required to by Justice. APIs are the hooks rivals use to integrate their software with Microsoft operating systems. While the proposed settlement only requires the company to disclose APIs for Windows, rivals say, Microsoft should also have to release the information for its media player, instant-messaging software, and other products. Otherwise, they argue, it will be harder for rivals to offer competing software.

Microsoft declined to comment on Lockyer. Chairman William H. Gates II has made it clear, however, that he would like to end the litigation. "As long as not everyone is signed up to a settlement, you still have some of the uncertainty," Gates told *BusinessWeek*. The way Lockyer is talking, that uncertainty could last a while longer.

By Ronald Grover in Los Angeles and Mike France in New York, with Jay Greene in Las Vegas

THE CAR GUYS TAKE CHARGE AT GENERAL MOTORS

Lutz's promotion marks another blow to brand management

In early August, nearly a month before he officially took over his job as General Motors Corp.'s vice-chairman for product development, Robert A. Lutz had already begun to shake things up at the auto giant. The former Chrysler Corp. car guru checked out the concept cars the company planned to show at the prestigious Pebble Beach classic car show later that month. Lutz astonished GM's design team by rejecting several of their prized models. In his typical fashion, he set them to work—nearly around the clock—to remake the designs before the show.

For stodgy GM, such behavior is downright revolutionary. That's just why chief Executive G. Richard Wagoner fired the industry maverick in the first

strong marketing, rather than innovative styling, to sell cars. The approach has largely failed: During his tenure, the company's share of U.S. vehicle sales slid a disastrous five percentage points, to 28%. GM had been backing away from brand management for some time prior to Lutz's arrival, and now, with Zarrella out, few of its proponents remain.

BY THE BOOK. Lutz still has to weed out some of its traces. To ensure consistency, for example, many rigid rules were set up that resulted in boring cars. Stylists had to consult lengthy design manuals for each division; some had 40-page sections just on designing each brand's crest. And that's not the only problem Lutz faces. In recent years, powerful engineering executives more interested in

He won't be alone, though. Gary L. Cowger, who was group vice-president of manufacturing and labor relations, will report to Lutz as president of North American operations. GM insiders say he's more willing to bend the rules to produce hot-looking cars than previous GM executives have been. Says Cowger: "Our job is to provide flexibility to do different styling."

The enthusiasm seems to be catching. In the past, GM's engineers, designers, and manufacturing execs have battled over vehicles, with engineering and manufacturing usually winning out. No more. "Lutz is getting no resistance," says one GM executive.

Even so, the new chief isn't taking chances. Lutz has also given designers more power. Final decisions on styling are now shared by the project's top engineering manager and the design chief. If there's a dispute, "I hold the tie-breaking vote," says Lutz.

Lutz has even gotten out his drafting pen. Although consumers won't see a car designed entirely under Lutz's watch until around 2005, they will see some of his editing work on models being

Eyes on the Prize Cars

Lutz (right) and Gary Cowger, president of North American Operations, reign over vehicle operations



DESIGN TEAM: They want "I gotta have it" cars



CHEVROLET SILVERADO: Designers have scrapped the initial concept for the next-generation pickup

SATURN SKY: The concept car is getting front-end changes, if not a full makeover



GMC TERRA4: Lutz has asked designers to soften the car's harsh lines

place. On Nov. 13, he took the gambit one step further by promoting Lutz to the post of chairman of GM North America. He takes over for Ronald L. Zarrella, a consumer-goods marketer who left GM after seven years to take over the EO's seat at his old employer, contact lens maker Bausch & Lomb Inc. Lutz's big challenge: reverse GM's market-share slide. "We've got to get our cars more in the 'I gotta have it' mode," says Lutz.

The shift marks the first time in years that "car guys" are in charge at GM's key U.S. unit. Zarrella, who spent four years as head of sales and marketing and three as president of North American operations, had championed brand-management philosophy that relied on consistent brand imagery and

cost savings and efficiency than design had gained influence, pushing design to the backseat. The result: too similar styling and chassis across GM's seven divisions.

Now Lutz, who will reign supreme over every aspect of vehicle operations from the design studio to the factory floor, wants to change all that. Responsible for such hits as the Chrysler PT Cruiser, he's the very definition of a car guy. Since September, he has ignored "recipe book design," says one senior GM designer. Nor does Lutz even look at market research until the exterior styling of a vehicle is completed. According to Zarrella, Lutz has been busy trying to get GM execs to realize that if customers don't like a car's exterior, "they'll never get in it even if you get marketing right."

launched in 2003 and 2004. He ordered changes to the next-generation Corvette and toned down the new Grand Prix sedan, set for launch in 2004. Designers say Lutz demanded more-dramatic styling for the next generation of full-size pickup trucks, due in several years, even as he softened designs for GMC and Cadillac. Take the STS, which replaces the Cadillac Seville and is expected to hit showroom floors in 2004. Lutz has rounded its harsh lines and given the car a more conservative appearance. "It looks a lot different than it did a month ago," marvels Dallas Cadillac dealer Carl Sewell. "He really helped them improve [it]." Now Lutz has a chance to work the same magic on all of GM's lineup.

By David Welch in Detroit



NICE DESIGN: But the Avantissimo may not save Paefgen's job

AUTOS

WHO'S BEHIND THE WHEEL AT AUDI?

The industry expects a bloodletting before VW Chief Piëch exits

Audi CEO Franz-Josef Paefgen doesn't seem like a candidate for the ax. In the first nine months of this year, Audi, Volkswagen's premium auto brand, was the group's most profitable unit by far, contributing more than a fourth of earnings. It boosted European sales by 10% in the same period, capturing a record 3.6% of the sluggish market to overtake rival BMW in Europe. And with the successful launch a year ago of the elegant, \$29,000, A4 sedan, Audi looks set to clinch a sixth consecutive annual sales rise.

That apparently isn't enough to satisfy Volkswagen CEO Ferdinand Piëch, who ran Audi before being promoted to the top spot at vw. Paefgen is likely to be swept away in a final bloodletting at the Volkswagen group before Piëch turns over the reins to his successor, Bernd Pischetsrieder, on Apr. 17, industry insiders say. The talk is that Paefgen's job will go to research and development chief Martin Winterkorn, one of Piëch's loyal lieutenants, as part of a reorganization of the group's nine brands. It's unclear whether there will be room for Paefgen, 55, anywhere in the group. Neither Paefgen nor vw is commenting on the rumors, but officials say a reorganization might be approved

as early as the supervisory board's next meeting on Nov. 23.

This little piece of corporate intrigue gives vw watchers some interesting clues about the carmaker's future. First is the question of Piëch's role after he steps down as CEO and takes up the nonoperating role of supervisory board chairman. The speculation in German car circles has always been that Piëch would put his trusted aides in key positions before his departure, to make doubly sure vw's progress adhered to his own precise vision. Winterkorn's promotion would confirm this thesis.

OVERDUE. The second conclusion to be drawn from this likely changing of the guard is that Piëch finally is coming to grips with problems he helped to create. A new brand strategy for all of vw—not just Audi—is long overdue. Unfettered competition among the auto company's 60-plus models has hindered vw's potential. In particular, the Czech-based, bargain-priced Skoda cars have lured

customers from vw and other marque. Piëch plans to divide vw's car brand into two main groups, conservative and sporty. vw, Skoda, and the aristocratic Bentley brand will be in the conservative camp. Audi, Lamborghini, and the struggling Spanish brand Seat will make up the sporty set, expected to turn out sexy, head-turning models.

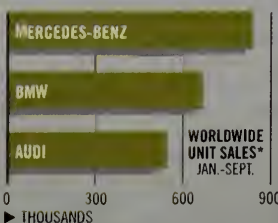
Audi stands to gain from the reorganization. Its A4 faces stiff competition from vw's slightly less expensive Passat. Paefgen's defenders say he has been hamstrung by Piëch's own maneuvers in favor of the vw brand. Case in point: Volkswagen will launch a luxurious, high-performance vw-badged car, code-named D1, next spring in Europe, before replacing the seven-year-old, \$64,000 Audi A8 sedan. Industry sources say a new A8 had been scheduled for launch in spring 2002, but has been delayed by a year—perhaps to give the \$65,000 D1 a clear shot at capturing customers.

Volkswagen officials riposte that the D1 is chasing the thousands of buyers each year who leave the vw brand to move upmarket but opt instead for BMWs and Mercedes. "The clientele for the D1 and A8 are different," says Thomas Bieler, sales chief at the Audi Zentrum Stuttgart dealership. vw tends to attract customers who are looking for traditional, family cars, while Audi evokes sporty, technologically innovative cars. "They won't get in each other's way." But car analysts say the D1 will cannibalize the next-generation A8. "I can't think of another product that attacks it more directly," says Christopher Will at Lehman Brothers in London.

Piëch's maneuvering doesn't mean that vw chief isn't plenty ambitious for Audi, which he ran from 1988 to 1993. Earlier this year, he lambasted Paefgen for the marque's bland product offering. Paefgen's advocates in the industry point out that recent Audi concept cars, such as the Steppenwolf coupé and the spacious Avantissimo station wagon, show that Audi designers have the kind of flair customers crave. True or not, Piëch still gets the final say.

By Christine Tieney in Frankfurt with Katharina Schmidt in Stuttgart

AUDI TRAILS RIVALS



Data: Company reports

EDITED BY MONICA ROMAN

CULTURE SHOCK T CSFB

ALL STREET SUPERSTARS aware: Credit Suisse First Boston's CEO John Mack, dubbed "Mack the Knife" for his aggressive cost-cutting, is tearing up guaranteed multi-year contracts for his investment bankers, including technology banking czar Frank Quattrone. On Nov. 1, Mack issued a memorandum to employees announcing that all investment bankers' pay packages will be tied more directly to the profits of the firm as a whole and to its divisions. With these changes, Mack wants to create a "one-firm" culture at CSFB. He also plans to save some \$375 million over the next three years, on top of the \$1 billion in costs he plans to wring out in 2002, partly by reducing the firm's global head count by 7%, or 300 jobs. Mack needs to move fast: CSFB is expected to report a \$120 million op-

erating loss for the third quarter on Nov. 20.

AOL, SONY, AND THE CONNECTED HOME

AOL TIME WARNER AND SONY have forged an alliance designed to enable consumers to conveniently connect all their Web-linked devices at home. The consumer-technology powerhouses are betting that more people will want to get broadband access when they can use multiple devices simultaneously and download music and other content from their PC to connected stereos, TVs, or other machines. Over the next few months, AOL and Sony will develop a "gateway" device that will link all the home machines, as well as an AOL micro-browser to navigate all of Sony's connected devices from handheld computers to camcorders.

A CAR RENTAL TITAN RUNS LOW ON GAS

THE DRAMATIC REDUCTION IN air travel has forced ANCO Rental, the parent company of Alamo Rent A Car and National Car Rental, into bankruptcy. National, the No. 3 car rental company, has been struggling since September 11 because 90% of its business is linked to airline passengers. The company has cut its fleet by 35%, brought in a chief restructuring officer, and reached an agreement with lenders to defer \$70 million in principal payments due Oct. 1—but it hasn't stopped the bleeding.

VF CUTS A NEW PATTERN

VF IS GETTING OUT OF THE pool. The world's largest apparel maker plans to trim \$115 million in annual costs by laying off 13,000 workers,

HEADLINER: RON ZARRELLA

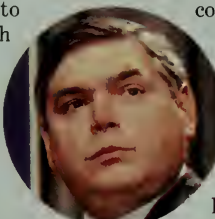
THE VISION THING AT BAUSCH & LOMB

RON ZARRELLA MUST LOVE a challenge. After seven years, the head of General Motors' North American unit is returning to struggling Bausch & Lomb (page 49). Zarrella left as president and COO of the Rochester (N.Y.) eye-care company in November, 1994. A month later, *BusinessWeek* raised questions about B&L's accounting that eventually led to the resignation of its then-CEO and a restatement of 1993 and 1994 results. The SEC later found that the company had violated antifraud statutes and improperly overstated revenues. B&L

has struggled ever since.

This time around, Zarrella will be chairman and CEO. Bausch & Lomb is counting on him to jumpstart revenues, still below their 1995 level of \$1.93 billion. That won't be easy. The company faces a Go-liath in Johnson & Johnson, which has 55% of the U.S. contact lens market, vs. B&L's 10%. Worse, J&J's replaceable lenses are cutting demand for lens solution, which accounts for more than half of Bausch & Lomb's revenue. Zarrella's first job: devising a new strategic vision.

Faith Keenan



or 18% of its workforce. The Greensboro (N.C.) maker of Lee and Wrangler jeans will take a one-time charge of \$280 million to \$320 million in the fourth quarter to cover the restructuring. "Our profitability remains at healthy levels," says company Chairman Mackey McDonald, "yet our return on capital has declined in recent years." To help improve performance, VF is putting its Jantzen swimwear line up for sale and consolidating its Bestform, Vanity Fair, and Vasarette intimate-wear businesses. It also plans to move more production overseas to lower-cost facilities.

THE LAST CHA-CHA FOR CHIQUITA?

THE PAST EIGHT YEARS HAVE been miserable for Chiquita Brands, a \$2.3 billion fruit marketer. In a last-ditch effort to stay alive, the 102-

year-old company has worked out a deal to turn itself over to creditors in a debt-for-equity swap and file for bankruptcy. Banana baron Carl Lindner, who stepped down as CEO in August, blames the company's woes on "eight years of an illegal European import regime." Chiquita claims it has sustained \$1.5 billion in damages since 1993 due to a long-running dispute over banana imports. Under a restructuring plan negotiated with bondholders, Lindner will have a seat on the new board of directors.

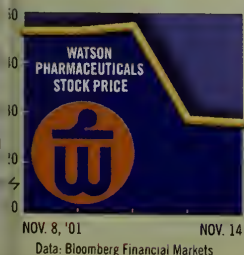
ET CETERA...

- Amgen won Food & Drug Administration approval for Kineret, an arthritis drug.
- Tribune Co. is freezing employee salaries and cutting the pay of 140 managers by 5%.
- Newmont Mining will become the world's largest gold producer via two acquisitions.

CLOSING BELL

FEELING POORLY

Shares of Watson Pharmaceuticals fell 39.5%, to \$28.54, on Nov. 13 after it said it would shift its focus from generic to branded drugs. The move will cut 2002 earnings to \$168.7 million—40% below analysts' expectations. To make the switch, Watson hired DuPont Pharmaceuticals veteran Joseph Papa as COO.



BY RICHARD S. DUNHAM

JOHN ASHCROFT SPEAKS LOUDLY AND CARRIES A BIG STICK

Since September 11, the nation's top cop, Attorney General John D. Ashcroft, has been a man on many missions—fighting terrorists, buttressing bridges to social conservatives, and bringing a conservative philosophy to the Justice Dept. on everything from antitrust policy to euthanasia. In the process, the former Missouri senator and Presidential candidate has become a political lightning rod. “He’s demonstrated an insensitivity of the grossest nature to the most cherished civil liberties,” roars Nan Aron, president of the Alliance for Justice, a liberal group that monitors judicial picks. Robert Levy, a constitutional scholar at the libertarian Cato Institute, adds that Ashcroft’s tactics are acceptable “if you think the Bill of Rights is scrap paper.”

But Ashcroft’s activism is serving a purpose: shoring up support for Bush among religious conservatives worried that the President had been too accommodating to Democrats since the terrorist attacks. So far, there has been little fallout. A Nov. 8-11 Gallup Poll found that 77% of Americans approve of Ashcroft’s handling of the war on terrorism.

MOVING QUICKLY. Apparently, Americans are willing to accept extraordinary measures to combat terrorist infiltrators. And that’s Ashcroft’s approach. He has pressured Congress to quickly pass an anti-terrorism bill that loosens restrictions on the government’s use of electronic surveillance and allows detention of terrorism suspects without charges. He has implemented new rules allowing the feds to monitor certain conversations between lawyers and their clients. And he backed a Nov. 13 Presidential decree that would subject some terrorist suspects to American military courts—a tactic used against Nazi spies and saboteurs during World War II.

At the same time, Ashcroft, a pro-life stalwart, has sought to void Oregon’s physician-assisted suicide law by reversing a

1998 opinion by then-Attorney General Janet Reno. And he has pleased business by announcing plans to shift enforcement dollars from antitrust, environmental protection, and civil rights to anti-terrorism—all while settling with Microsoft.

President Bush has stood firmly behind Ashcroft, but the Attorney General’s blunt style has created problems across the political spectrum. He angered Congress by suggesting that it would be held responsible for future terrorist acts if it failed to pass, within a week, the anti-terrorism curbs he was seeking. “The perception is this is what the American

people want,” says Representative Ron Paul (R-Tex.). “But ultimately it will hurt the American people and do nothing to help us catch the terrorists.”

Ashcroft has also deepened the rift between the Administration and the legal Establishment. Earlier this year he ended the American Bar Association’s traditional role as a pre-screener of judicial nominees. He further angered the ABA by moving to allow prosecutors to listen in when attorneys talk with their clients—if approved by a judge. “Since the reign of [Queen Elizabeth I, we have understood the

need for attorney-client privilege,” says ABA President Robert E. Hirshon. “[This] will have a very chilling effect.”

At the other end of the civil liberties argument are social conservatives like Eagle Forum President Phyllis Schlafly, who complains: “I’m a big supporter of Ashcroft, but I do not believe he’s tough enough on the aliens.” Ashcroft, who declined interview requests, can live with that kind of heat. His hard-line tactics are for the most part reassuring conservatives nervous about Bush’s recent shift to the center. And the terrorists can be kept at bay, the public is likely to conclude that the Attorney General’s ends justify his means.

With Lorraine Woellert and Dan Carne



TOP COP: The AG’s blunt style has irked many

CAPITAL WRAPUP

THE NEW BIPARTISANSHIP

► White House Budget Director Mitch Daniels has figured out a way to unite Democrats and Republicans who had been feuding about government spending: Make everyone mad at him. After Daniels labeled the lawmakers “big spenders,” House Republicans proposed an additional \$11 billion in reconstruction aid for New York and Senate Dems sought \$20 billion for infrastructure spending. Vice-President Dick Cheney is trying to soothe the ruffled egos.

A SETTLEMENT FIT TO PRINT

► When the Justice Dept. and Microsoft agreed to settle their longstanding antitrust suit, they agreed to buy space in *The Washington Post* and *San Jose Mercury News* to publish the 18-page accord. But presiding Judge Colleen Kollar-Kotelly expressed skepticism about the breadth of their readership at a Nov. 6 hearing. The judge added *The New York Times* to the list. Losing out: *The Wall Street Journal* and *USA Today*.

WE WANT RUDY

► Republicans are hoping that New York Mayor Rudy Giuliani will be their secret weapon in 2002. House GOP leaders want the wildly popular Giuliani to campaign in closely contested races. It’s a role filled last year by maverick Arizona Senator John McCain. But Giuliani’s appeal may not be as effective as McCain’s populist agenda. Rudy’s ads extolling GOP gubernatorial candidates in New Jersey and Virginia failed to sway voters on Nov. 6.

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EDITED BY ROSE BRADY

U.S.-RUSSIA: JUST HOW FAR WILL THE LOVE-IN GO?

George W. Bush and Vladimir V. Putin—or do they now call each other “Dubya and Vlad?” In three days of talks and socializing at the White House and Bush’s ranch in Crawford, Tex., Nov. 12-15, the Presidents of the U.S. and Russia took key steps to develop the alliance that has flourished since the September 11 terrorist attacks. Among other things, Bush and Putin agreed to historic cuts in nuclear arsenals—down to as low as 1,700 on both sides—and on joint efforts on everything from bioterrorism to economic development. “The United States and Russia have overcome the legacy of the cold war. Neither country regards the other as an enemy or threat,” the two Presidents declared in a joint statement.

Not that there won’t be bumps ahead. One issue on which the two leaders disagreed in Washington was the 1972 Anti-Ballistic Missile (ABM) Treaty. An even bigger problem that could arise down the road if the U.S. expands its campaign against terrorism is Russia’s close relations with Saddam Hussein’s Iraq. But Putin’s decision to ally Russia firmly with the West—plus the strong rapport between the two Presidents—offer a chance for them to make progress on problems that once may have seemed intractable.

BARGAINING POSTURE. Take the ABM treaty. Bush needs to persuade Putin that it’s obsolete so the U.S. can test an antimissile defense system without violating the pact. Putin still thinks the ABM treaty is important and made it clear in Washington he prefers any new nuclear arrangements with the U.S. to be in writing. But Administration officials think that’s mainly a bargaining position. Says one: “The Russians are prepared to be flexible on what we test.” Russian analysts say Putin may well be angling for a promise that Russia’s defense industry benefits from missile defense. That meshes with his goal of linking Russia’s economy to

the West’s. And it could ease opposition from hard liners who are happy about Putin’s bid for closer Russia-NATO ties.

The Iraqi question may be trickier. Russia has longstanding relations with Saddam Hussein’s regime, which owes Russia \$1 billion in Soviet-era debt. So, according to conventional wisdom, Russia would not accept any U.S. military campaign against Iraq. Still, that may be less true post-September 11, especially if Washington presents clear evidence against Saddam. Moscow aligned itself with Baghdad during and after the war partly to challenge America. With the U.S. and Russia fighting terrorism together, that motivation has disappeared. “For Putin, Iraq is not so important now,” says Moscow defense analyst Andrei A. Piontkovsky.

Moreover, Putin could try to extract a steep price for allowing a decisive U.S. strike against the oil-rich Iraqi state. Russian oil majors have curried favor with Saddam’s regime with an eye on future contracts. But if Bush quietly guarantees that Russian oil companies will get a prime slice of the Iraqi oil, Putin might go along. “There is a good case for a behind-the-scenes bargain,” says Dmitri Trenin, analyst at the Carnegie Moscow Center. For now, Putin has called for the renewal of international inspections in Iraq. If Saddam refuses, Putin can save face if the U.S. goes after Iraq by citing Saddam’s intransigence to his own proposal.

It’s hard to say where the U.S. will take the war on terrorism next. Debates with Russia on the war—and other issues—will continue. But the Russian-American dialogue has changed remarkably: No one would have predicted that a Russian President would invite the U.S. military into nearly Central Asia. Don’t be shocked if Bush and Putin find ways to surmount other obstacles to their alliance.

By Paul Starobin in Moscow and Stan Crock in Washington



BUDDIES: Bush and Putin

GLOBAL WRAPUP

SELF-RULE FOR KOSOVO?

► The U.N.-administered Yugoslav province of Kosovo could take a big step on Nov. 17 toward achieving more autonomy. Voters will elect an assembly that, in turn, will choose a president for the once war-torn province. The U.N. will still be in charge, but Kosovars can begin taking a wider role in running their own affairs, from providing better health care to spurring economic growth.

Parties representing Kosovo’s ethnic Albanian majority, still bitter over re-

pression at the hands of Serbs before NATO troops moved in 1999, are expected to win big. A large chunk of the 120 seats is likely to go to the Democratic League of Kosovo, whose leader, Ibrahim Rugova, would become President. He favors autonomy for the province but is more moderate than the leader of the rival Kosovo Democratic Party, which is led by the former commander of the Kosovo Liberation Army, Hashim Thaci. The one Serb party running, Coalition for the Return, is guaranteed 10 seats in the assembly and could win a handful more.

Both the U.N. and European governments hope that the new Kosovo assembly will help ease tensions between ethnic Albanians and Serbs. “By slugging it out in the assembly, we hope they can learn to work together,” says Susan Manuel, U.N. spokeswoman in Kosovo. Indeed, the 200,000 Serbs that fled Kosovo are being urged to vote. Whether the shaky peace holds will depend a lot on how responsibly Rugova—and the Kosovo assembly—will lead. If they push for full independence, all bets may be off.

By Christopher Condon in Budapest

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FORECASTING

THE CASE OF THE CORPORATE SPY

In a recession, competitive intelligence can pay off big

When executives at Texas Instruments Inc. began suspecting that a rival might move to acquire Telogy Networks Inc. two years ago, it set off alarms deep within the company. At the time, Telogy provided the software for TI's Internet telephony hardware, so a rival's acquisition of the company would be disastrous. A half-dozen executives, acting as TI's corporate spies, sprang into action, quickly contacting Telogy execs and dispatching finance people to research the company. The "competitive intelligence" they developed convinced management that it needed to acquire Telogy quickly—and safeguard what is now a \$100 million business with enormous growth potential at a time when bright spots on the tech horizon are few. "It's a fact: If you snooze, you lose," says Jeffrey S. McCreary, senior vice-president for worldwide sales and marketing. "Competitive intelligence is your best alarm clock."

Never is that truer than during a recession. For what amounts to a fairly modest investment, it is possible for a company to create a competitive-intelligence unit that gives its managers the one thing they need most in a downturn: a crystal ball. They can't predict the future, but corporate spies can help

managers understand what competitors have up their sleeves, information that they can use to deploy scarce resources, price products and services, modify strategies, and avoid costly mistakes. "When you're going into a war situation,

CLOAK AND DAGGER

How three companies used corporate intelligence

AVOID LOSSES Analysts at electronics distributor Avnet accurately predicted the exit of four top competitors, allowing managers to focus marketing resources and avoid a price war

BOOST SALES Flooring company Pergo, learning that a rival was going to miss the launch date for a new product, used that info to win a contract with a top retailer

MAKE BETTER DEALS Texas Instruments moved quickly to acquire Telogy Networks—whose software was key to its Internet telephony offerings—after corporate spies learned that a rival might do the same

you don't want to be cutting the budget of the CIA," says Michael Mace, chief competitive officer at handheld-computer maker Palm Inc. "And when you're going into a recession, you don't want to be cutting your ability to look into the future."

Competitive intelligence involves legal methods of data collection and analysis, from scouring securities filings and news reports to database research to schmoozing with representatives of rival companies at trade shows. That's different from corporate espionage—the theft of trade secrets through illegal means such as wiretaps, bribery, and cyberintrusions.

Still, some intelligence-gatherers stretch over the ethical line. Procter & Gamble Co. last year hired spies to snoop on rival Unilever PLC but pulled the plug when it discovered that one of them had rifled through Unilever's trash. And Oracle Corp. admitted that detective it hired paid janitors to go through Microsoft Corp.'s garbage, looking for evidence to use in court.

SOPHISTICATED TOOLS. The ranks of legitimate spies have risen dramatically, by over 220% in the past decade, so that more than 5,000 corporate spies are now actively engaged in intelligence activities. Nine out of 10 large companies have employees dedicated solely to the competitive-intelligence function, according to Leonard M. Fuld, president and founder of Fuld & Co., a Cambridge (Mass.) intelligence consultant. Most reside in marketing, strategy, and information-services departments, answering to anyone from midlevel manager to the CEO. Increasingly, corporate intelligence-gatherers are better educated—many have MBAs or professional certification, or have studied corporate spying at the growing number of universities that offer courses in it, including Brigham Young University and the University of Pittsburgh. And the tools at their disposal, including search engines, are more sophisticated.

Many large U.S. companies spend upwards of \$1 million a year tracking their competitors, and they build the information right into their sales strategies. The top corporate spy at a multi-billion-dollar global technology company, who requested anonymity, says intelligence helped his company recover after it was blindsided by a competitor. The rival, after going toe-to-toe with the company for years, had figured out its bidding strategy. Instead of competing on price with an off-the-shelf offering, the rival was beginning to offer prospects a customized solution—and it

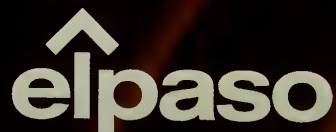


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Management

was winning. When the spy's compar- shifted gears to a customized approach it won hundreds of millions of dollars in new business the following year. At Pergo Inc., a maker of laminate flooring, intelligence helped steal a major contract right out from under a rival's nose. When Pergo told a national retailer what it had learned from a mutual supplier—that the rival would not be able to launch a new product when it said would—the retailer signed with Pergo instead. Says Senior Product Manager David Sheehan, Pergo's corporate spy: "It's not rocket science. It's basic blocking and tackling."

Competitive intelligence can also help companies avoid unnecessary costs. A Phoenix-based electronics distributor, Avnet Inc., in-house analysts predicted—correctly—that four of its rivals in the server industry would soon be out of business. So when two of them began offering special financing deals to grab market share, Avnet stayed on the sidelines. Intelligence developed by Avnet's analysts allowed company managers to avoid a potentially crippling fight and to compete forcefully with the rivals that remained. Says Eric Scheer, a business intelligence analyst at Avnet: "It gave them some vision down the road and assisted them in creating new strategies. It helps them make much more informed decisions than they could have made in the past."

LEG UP. Increasingly, that's a lesson lost on many companies. When demand dried up, says Bill Lewis, director of McKinsey Global Institute, competitive intensity increases dramatically. Yet when companies are besieged by collapsing profits, it gets harder to justify a team of crystal-ball gazers. In fact, Avnet lost one of its four corporate spies during companywide layoffs in October, and the unit's budget for the year is down 20%. Kairn Pawlikowsky, manager at Avnet's business intelligence office, says the cutbacks will not hamper its ability to gather intelligence.

Industry-sponsored research, while far from conclusive, suggests that companies that engage in corporate spying see a payoff in increased revenue, costs avoided, and better decision-making. With the economy in free fall, those advantages can make all the difference. "Visibility in the business world is so low right now," says Mark R. Little, director of strategy analysis for Glaxo-SmithKline PLC. "If you don't have competitive intelligence, you're going to be in trouble." And if you do, at least you'll see it coming.

By Louis Lavelle in New York

Has Your Goodwill Gone Bad?



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BERTARELLI:
A yachtsman at Serono's helm

At the helm Serono today is 29-year-old Ernesto Bertarelli, who replaced his father as CEO in 1996. An avid yachtsman who is well known on the European social circuit, the young Bertarelli brings more than just glamour to the job. He has established a modern, centralized management structure organized in therapeutic areas. And he has built up Serono's brand in 4

BIOTECHNOLOGY

A VENERABLE BIOTECH EYES THE NEW WORLD

Serono CEO Ernesto Bertarelli has designs on the U.S.

Anyone with a passing interest in biotech is probably familiar with American icons Amgen and Genentech, the two biggest players in the field. But the third-largest contender, a \$1.24 billion Swiss giant called Serono, will be a new name for many Americans—even though it is in fact the oldest of them all.

Founded in Rome in 1906, Serono was a traditional family-owned outfit that flourished because of a single, best-selling fertility drug derived from an unlikely source: It was a protein purified from the urine of postmenopausal women—specifically, from Italian nuns. “Not exactly the sexiest raw material,” concedes Serono’s chief financial officer, Jacques Theurillat. “Today the company is totally different.”

GLAMOUR. And how. Serono was completely overhauled by the late CEO Fabio Bertarelli, who moved the headquarters to Geneva in 1977 and introduced recombinant-DNA production technologies and cutting-edge biomedical research. Today, Serono is the world leader in reproductive treatments—but that’s just the beginning. It also has hot-selling drugs for multiple sclerosis and other

autoimmune diseases, growth deficiency, and AIDS-related wasting. There are 15 new compounds in development. And researchers are now drawing a bead on prions, the rogue proteins thought to cause mad cow disease. “Serono’s transition has been very effective,” says Commerzbank’s biotech analyst, Steve Cox.

different countries—with a special emphasis on the most competitive markets of all, the U.S.

Bertarelli, the third generation of his family to head the company, has the right credentials. After spending time as a salesman, project manager, and financial analyst at Serono, he went to Harvard to get his MBA in 1994. While other students were out on job interviews, Bertarelli would sift through the ream of company documents that were sent each week by his father, who by now was suffering from cancer. “He’d call and say, ‘Have you read that letter? What do you think?’” Bertarelli recalls. The day after graduating, Bertarelli flew to Geneva and was installed as CEO.

Since then he has rapidly made his mark. He increased the company’s spending on research and development

The Drugs Driving Serono's Growth

NAME	FUNCTION	SALES*
Gonal-F	A recombinant hormone used to treat ovulation disorders that impair fertility. Also helps men produce hormones needed for sperm production.	\$301
Rebif	A beta interferon drug that delays the progress of multiple sclerosis and relieves its symptoms. The leading treatment for MS outside the U.S., it is a potential rival to Biogen’s drug, Avonex.	269
Serostim	A recombinant human growth hormone that reverses the metabolic upset linked to AIDS-related wasting.	98
Saizen	A treatment for growth hormone deficiency in children and adults.	78

* All sales, in millions, are for the nine months ended Sept. 30, 2001. Data: Company reports, Merrill Lynch & Co.

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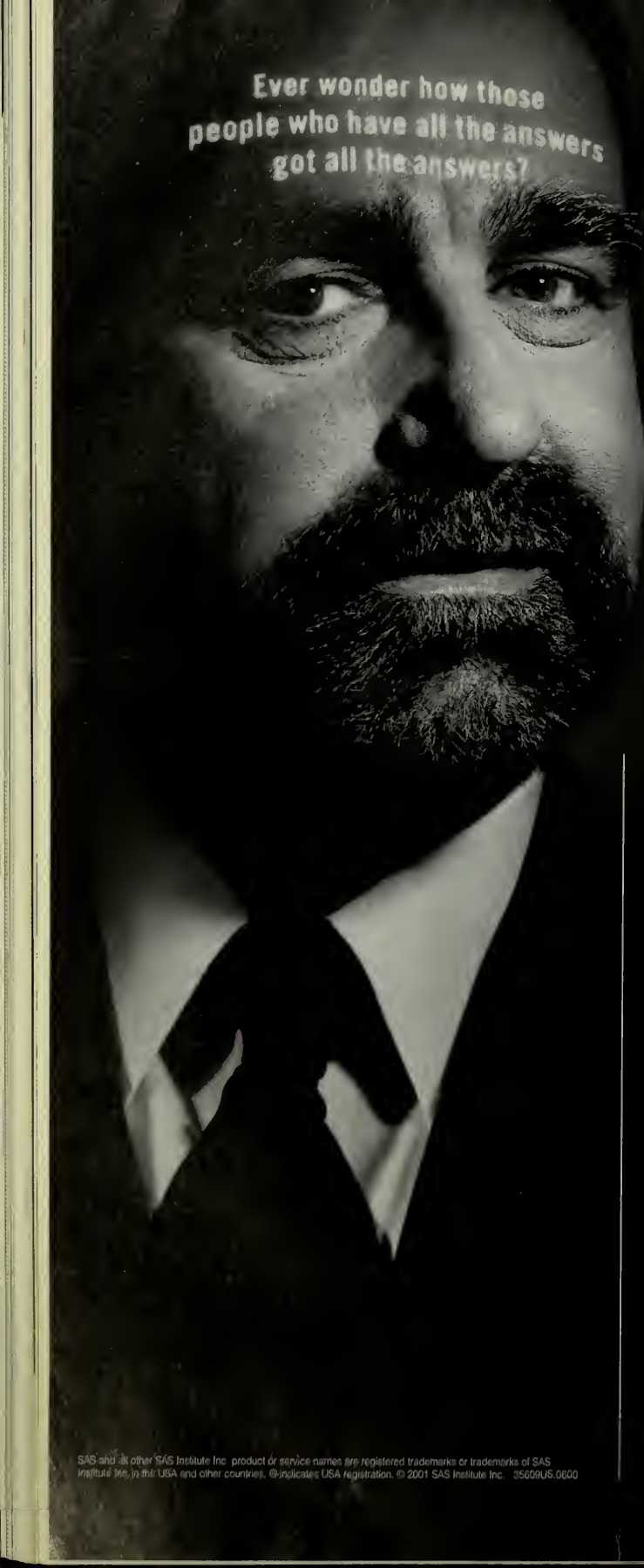
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to an astonishing \$300 million—about 4% of estimated 2001 sales—up from 7%, or \$114 million, in 1993. Over the past three years, operating income has more than doubled. Last year, Bertarelli orchestrated one of the biotech industry's biggest secondary offerings on the New York Stock Exchange, raising a war chest of \$1 billion.

Bertarelli won't use that money to make splashy acquisitions. Instead, he's plotting a slower, more methodical course. To increase U.S. sales to 60% of total revenues in five years, from 35% now, he'll use the cash on Serono's looks to strike up innovative biotech collaborations. One example: a \$52 million codevelopment deal with Seattle-based ZymoGenetics Inc. in September. Their goal is to develop drugs

against autoimmune diseases based on two proteins discovered by the American partner—molecules involved in the overproduction of antibodies that attack the body's own cells in diseases such as multiple sclerosis and lupus. "We can be a bridge for biotech in Europe, but our future is in the U.S.," says the CEO.

MARKETING DRUGS. Long before these research partnerships pay off, however, Serono hopes to build up a U.S. beachhead with its beta-interferon treatment for MS, a drug called Rebif. The compound is already available in 72 countries. But sales of Rebif are blocked in the U.S. by a competing drug from Biogen Inc., called Avonex. The Food & Drug Administration has granted marketing exclusivity to Biogen through 2003, under a law called the Orphan Drug Act.

This law was passed in 1983 to give drugmakers incentives, in the form of tax breaks, grants, or exclusive marketing rights, to develop treatments for diseases that affect relatively small numbers of people. To break a product's orphan-drug status, a competitor must prove that its new drug is safer, more effective, or easier to deliver. That's exactly the tack Bertarelli plans to take with Biogen's Avonex. And he has spent \$30 million over the last two years on a head-to-head trial. The result: "On all primary and secondary efficacy measures, Rebif was superior to Avonex after six months of treatment," says Merrill Lynch & Co. biotech analyst Dr. Eric Hecht. Serono submitted its material to the FDA and expects a decision by mid-2002. Biogen, for its part, says

that six months is not enough time to judge the effect of a drug. What's more, a company spokesperson says Biogen is confident that its orphan-drug designation will be upheld.

Nonetheless, analysts who cover Serono believe Rebif will be approved by the middle of next year and will achieve rapid acceptance. The worldwide market for MS drugs, currently \$2.2 billion, is expected to reach \$4 billion by 2005, according to Merrill Lynch. By that time, Merrill expects Rebif to be the world leader, with \$506 million in U.S.

sales alone and 36% of the global market. Bertarelli plans to spend an additional \$30 million in the last quarter of this year to prepare for the anticipated U.S. launch.

Serono, which suffered from slower than expected

growth in the third quarter, could use some good news. The company had predicted a 20% increase for 2001 earnings but recently lowered that to 6% to 8%. Increased spending on marketing for Rebif, a decline in sales of fertility treatments, and lower interest income as a result of U.S. rate cuts were to blame, says Commerzbank's Cox. Most analysts, however, say the slowdown in earnings is likely to be a short-term dip as long as the company moves quickly to license new compounds.

AFTER THE CUP. Bertarelli can take comfort in the fact that most biotechs are in the same boat: All are heavily dependent on just a few core drugs. In Biogen's case, Avonex accounts for 82% of sales. But Bertarelli is optimistic that Serono's pipeline, coupled with more external collaborations, will be sufficient to fuel future growth. The company has allocated \$70 million next year on discovery efforts alone, an increase of nearly 15% from the previous year.

While Serono's scientists hunker down in the lab, Bertarelli is preparing for a different kind of challenge. A lifelong sailor who practices whenever he can on Lake Geneva, Bertarelli has launched a \$70 million Swiss bid for the 2003 America's Cup in New Zealand. Bertarelli, who hopes to be on board, is quick to point out that the funding is coming from himself and a handful of corporate partners. But if Bertarelli is to fulfill his dream of taking part, he needs to make sure it's smooth sailing for Serono in the months to come.

By Kerry Capell in Geneva

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KEEPING COCKPIT CONTROLS OUT OF HIJACKERS' HANDS

PREVENTING A RECURRENCE of the September 11 atrocities is the No. 1 priority for Theodore A. Postol, a Massachusetts Institute of Technology professor who specializes in security issues. Even today's tighter airport-security measures are "a half-assed job that's just not acceptable," he scoffs. And some proposed cures might be worse than the disease. For example, modifying the autopilot system so ground personnel could seize control of a plane may seem clever—until hacker-terrorists learn to hijack planes remotely.

Instead, Postol wants the autopilot changed so that cockpit controls work only when a plane is flying within its authorized air corridor. If a plane deviates from its flight path, the autopilot would take over and bring the plane back on course. In an emergency, a pilot could request a special code that would reroute the plane to the nearest airport—but nowhere else.

Postol also calls for video recording of the passenger cabin—viewable from the ground before any jet is ordered shot down. "You want to be absolutely sure that this terrible choice is not as bad as the alternative," he says. These steps will be costly, but the U.S. can no longer tolerate "all those potential missiles flying around with no control over them." *Otis Port*



A BICYCLE YOU CAN READ BY

LIGHTS AND REFLECTORS ARE A CYCLIST'S BEST NIGHTTIME defense. Still, many cyclists are struck by careless motorists. Three University of Florida engineers think they can cut down on such accidents with the help of electroluminescent strips. The one-pound system blinks for up to 30 hours on just three 9-volt batteries.

The glowing material isn't anything new, concedes assistant engineering professor Christopher Niezrecki, who came up with the bright idea. These low-temperature, light-emitting phosphorus compounds have been used for years in watches and plug-in night-lights. Niezrecki found a clever way to stretch the luminous strips and apply them to the bike frame and wheel rims. Together with undergraduates Gregory Yoder and Matthew Young, Niezrecki built a glowing blue prototype, which drew rave reviews at a recent Las Vegas trade show. Now, with a patent in the works, the university is looking for commercial partners to mass-produce the system for around \$70 per bike. *Adam Aston*

RATS, CHILDREN, AND THE RIDDLE OF RITALIN

STUDIES IN RATS SUGGEST that high doses of the drug Ritalin, used to treat attention deficit-hyperactivity disorder (ADHD), cause brain changes like those produced by cocaine or amphetamines. "Our data suggest there are cellular reactions to Ritalin that last longer than the three or four hours it's working on ADHD symptoms," says Joan S. Baizer, a neuroscientist at the State University of New York at Buffalo.

She says the changes produced by Ritalin might be neutral—or even beneficial—and children should not stop

taking it. "I give my own children Ritalin," says Baizer, who reported her results on Nov. 11 at the annual meeting of the Society for Neuroscience in San Diego. "It's a very safe and effective drug."

Baizer says Ritalin alters the activity of a gene called *c-fos*, part of a system that controls other genes in neurons. The significance of this isn't clear, but it also occurs with cocaine and amphetamines, which, like Ritalin, are stimulants. There is, however, no evidence that Ritalin is addictive.

Ritalin's maker, Novartis, says controlled long-term studies haven't been done, but observations of children and young adults show no adverse effects. *Paul Raeburn*

ONE WAY TO KEEP UP WITH THE BUGS: GENE COCKTAILS

THOUGH THE U.S. IS RUSHING to make enough smallpox and anthrax vaccine to cope with bioterror attack, those vaccines won't help against other germs. But a group of scientists at the University of Texas Southwestern Medical Center has a possible solution: a quick way to crank out vaccines against new biothreats.

The basic idea: Inject different cocktails of genes from a bacterium or virus into different animals. Those genes, in turn, will cause the animals to make proteins. And the proteins will stimulate immune responses.

Scientists then infect each animal with the bacterium or virus—and see which creatures can fight off the germ. If the animals are protected, the researchers can figure out which protein did the trick. That protein becomes the basic material for an effective vaccine. Says Stephen Johnston, director of the university's Center for Biomedical Inventions: "Rather than trying to guess what bug a crazy person" might use, the method makes it possible to respond relatively quickly to deadly new threats. Program managers at the Defense Advanced Research Project Agency, which funded the work, hope it may be possible to make a vaccine for a new pathogen in days. Johnston estimates, however, that it would take nine months to a year for full development.

To prove the principle, Johnston has made a vaccine against chlamydia and another bug. Now, he's eager to try his hand at making smallpox and anthrax vaccines that don't have the side-effects of today's versions. The university has licensed the technology to Dallas startup Eliance Biotechnology for commercialization. *John Carey*



King Fahd of Saudi Arabia

20 years of growth and stability

“He has done what I would regard as the two main things for any leader of any country, to uphold all that is best of the old, and to take all that is best of the new and harness it and see that people actually profit from it.**”**

—Margaret Thatcher

THE greater world, as well as Saudi Arabia itself, has reason to celebrate the 20th anniversary of the reign of King Fahd. For two decades, he has been the quiet symbol of stability and diplomacy in a region in which these virtues have sometimes been in short supply. He has proved a skillful if understated crisis manager. He has also overseen the astonishing material development of his nation, whilst ensuring that its spiritual values remain strongly rooted.

His kingdom's achievements have to be seen in their actual context. Saudi Arabia is not the exclusive, exotic and fabulously wealthy place of legend. It is subject to real pressure at many levels.



Natural gas will join oil in a with huge future potential

It has to balance its unique position at the very heart of the Islamic world with its global and regional responsibilities as the world's leading oil producer and a major Middle Eastern power.

Saudi oil reserves account for a quarter of the world total. This gives the country a special, and sometimes stressful, global significance. It is a key to global energy markets, and thus to global growth and prosperity. Its consistent policy has been to provide a reliable supply of oil at a price reasonable to both consumer and producer. At the same time, however, it has no monopoly. It does not control world prices.

On a regional basis, Saudi Arabia has remained a stable and peaceful core in an area sometimes wracked by turbulence. King Fahd has invested much time and personal interest in efforts to solve longstanding problems and in dealing with immediate crises. His low-key and pragmatic manner means, however, that his successes attract little publicity.

Internally, as Crown Prince and then as King, he has navigated both a boom period of explosive growth and huge oil



The farm sector: exports of milk, grain, vegetables and fruit are booming

receipts, and more recent years of belt tightening and dramatically reduced income. The world oil price, starting to slide from a historic high of almost \$40 a barrel at the start of his reign in 1982, fell as low as \$10 a barrel in 1998.

Only in 2000 did recovery in the oil price end a string of 17 successive budget deficits. Before this, the government had to cope with

burgeoning population and increasing commitments at a time of plummeting revenues. The crisis, which passed largely unnoticed in the consumer countries, was managed successfully. King Fahd has actively encouraged diversification to lessen dependence on volatile oil receipts, and the educational and training programs necessary to attain it.

Another of his roles is unique, and spiritual. As the Custodian of the Two Holy Mosques, of Makkah and Madinah, the King is the protector of the two holiest sites in Islam. He has taken his responsibilities to heart. As well as a massive expansion in the capacity of the holy sites to accommodate pilgrims, Saudi Arabia has funded the building of mosques in many countries.

Saudi Arabia's immense size, three and a half times that of Texas, presents challenges of its own to its people and its monarch. Their responsibilities extend well beyond their own borders, however. They have a global role in energy. They are essential to the stability of a region of great strategic significance. They also play host to more than two million pilgrims a year, for the country is the cradle and the enduring focal point of Islam.

The country's ability to cope with these pressures is a tribute to the balance and continuity supplied by a monarchy based on consultation and consent. It also reflects King Fahd's personal support for benevolent and enlightened change.

Former President George Bush, speaking in a recent interview with Middle East Broadcasting, MBC, describes him as "an extraordinarily cooperative, determined, principled monarch. He's a wonderful man. I have known him personally. I have known him in a most respectful way."

A quiet determination to see through a crisis is a characteristic noted firsthand by Richard Murphy, former US Ambassador in Riyadh. "I think that King Fahd has been the very symbol of Saudi Arabia in critical years of world crisis," he says. We tend to think in America often of the crisis involving the Iraqi invasion of Kuwait, but his name, his face, has been associated with world developments in oil, world developments in terms of the Iran Iraq war, and perhaps less known, what he has achieved and how he has led Saudi Arabia in terms of the modernization of that government."

He has overseen, as Crown Prince and as King, much of the extraordinary journey from a rural and partly nomadic society to a modern urban and industrialized nation.

Where there were no hospitals, there are now more than 100, with nearly 45,000 beds. Where almost all were illiterate, five million students are now enrolled in over 24,000 schools, eight universities, and scores of colleges and training centers.

A new middle class, of managers, administrators, business executives, doctors and other professionals, has been created. And, it might be added, the Kingdom now has a world-class football team, which recently qualified for the final stages of the World Cup for the third time in a row.

This has taken place over little more than a generation. A transformation of such scale and pace might have shaken society and left it traumatized. It has been achieved peacefully, however, and without rupture.

King Fahd has contributed strongly to maintaining social cohesion and traditional values. As a former education minister, he has championed high standards in education and training. He took a lead in urging young Saudis to study abroad, in the US, Europe and Japan, in the days before higher education was established at home. The giant country is not a sparsely populated, and thus easily managed, wilderness. The population has doubled to some 20 million over the two decades of King Fahd's rule. It continues to climb at about three per cent a year. Three Saudis in five are under 21.

Hundreds of thousands of new jobs will be created over the next five years in response to the rapidly growing numbers of young Saudis entering the job market. In addition to its own citizens, Saudi Arabia employs large numbers of workers from neighboring countries, such as Yemen and Egypt. The openness of job markets provides prosperity and opportunity well beyond the Kingdom's borders. In this, as in much else, the country is subject to regional as well as national pressures. A delicate

The 875 feet high Al Faisaliah complex in Riyadh is one of the world's most futuristic buildings



balance has been held between conservatives, who uphold the Kingdom's distinctive ethos, and modernizers. The country has the most up-to-date communications, for example, in terms of Internet access, television, newspapers and major publishing houses, whilst retaining its unique and distinctive character.

The strong tradition of consultation in Saudi society has helped to preserve this equilibrium. So, too, has the King's ability to listen and his concern for the Saudi people. "I will be the father to the young, brother to the elderly," he has said. "I am but one of you; whatever troubles you, troubles me; whatever pleases you, pleases me." He has been sensitive to problems, seeking to find a balance of opinion on issues.

He took measures to streamline and revitalize the existing political and administrative system in 1992. The reforms marked a move towards a more broadly based involvement in the Kingdom's political processes.

King Fahd introduced a new Basic Law, which retained the tradition of informal consultative meetings between the king and any citizen with a point to make or problem to air. The participative nature of Saudi government was formalized in the Majlis Al-Shoura, the Consultative Council. Its members, originally sixty strong but now numbering 120, make recommendations and advise the King on a wide range of issues.

Members represent a mixture of clan and religious leaders, government officials, and business and professional men. Academics, many with advanced degrees, form the largest group. The 13 regional councils are each headed by a regional governor.

The Majlis Al-Shoura provides an institutional framework for the traditional form of Saudi Arabian government to function effectively in the increasingly complex and interdependent modern world. The reforms do not signal a shift from Islamic traditions, however. King Fahd has stressed that his reforms are based on Islamic principles of fairness, decency and popular consultation.

The King has the patience and discretion of a natural diplomat. These qualities have been of particular value in the region.

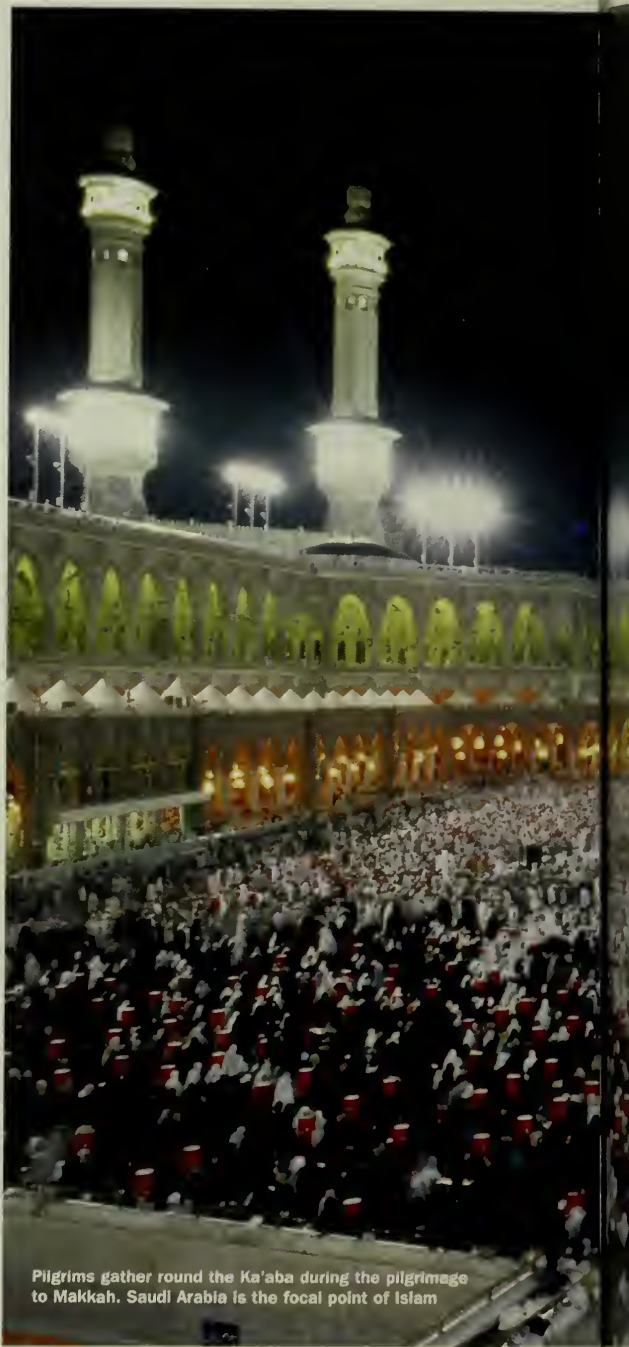
Arabia's once unmapped vastness led to border problems with Qatar, Yemen and Kuwait. His reign has seen the resolution of these issues, which had lingered for a half a century.

He has personally and actively supported efforts to seek a peaceful resolution of the Arab-Israeli conflict. His consistent policy has been to "realize a just and comprehensive solution to the Palestinian question that would establish justice and restore legitimate rights, and lay down a permanent basis for peace, security and stability."

He helped to broker an agreement that ended fourteen years of bloody civil war in Lebanon. The King's visit to Egypt in March 1989, where crowds greeted him on the streets of Cairo, marked the end of Egypt's temporary isolation within the Arab world.

King Fahd played a major role in forming Arab, Muslim and international support for the effort to liberate Kuwait during the 1990-1 Gulf crisis. Meeting with President George Bush in Cupertino, the King helped to put together a coalition of Arab, Islamic and other countries to implement United Nations Security Council Resolutions.

"I think that the stance he took in the Gulf War established his position for good and all, as a very wise statesman who is able to take strong decisions and right decisions," Lady Thatcher,



Pilgrims gather round the Ka'aba during the pilgrimage to Makkah. Saudi Arabia is the focal point of Islam

STONE

British Prime Minister at the time, told MBC. "The influence of King Fahd of course extends far beyond his country's borders, first because he is a devout believer in Islam, and second because he is widely respected for the views which he holds and the way in which he governs." The King was also one of the first leaders to realize the severity of the threat posed to Bosnian civilians by Serbian ethnic cleansing. He directed a massive Saudi campaign to ease civilian suffering in the war-torn country. The Saudi government denounced the attacks in New York and Washington of September 11, and assured



America that "we stand with you in the battle against global terrorism and in the search for peace and justice."

The breadth of Saudi Arabia's international interests reflect in the organizations it supports. The Kingdom is a founding member of the United Nations, the League of Arab States, the Organization of the Islamic Conference, and the Organization of Petroleum Exporting Countries.

It is one of the six founding members of the GCC, the Gulf Cooperation Council. The GCC is a bold move towards regional integration. Its rapid progress has been aided by the

common social, economic and cultural make-up of members states, and by their shared religious commitment. The King's standing as a leading figure in the GCC facilitates his efforts to promote peace and cooperation in the Gulf region.

His country has changed immensely in physical terms through his years as Crown Prince and King. Its spiritual bedrock, however, and its commitment to peace and the unity of the Arab and Islamic worlds, have not altered. For this, and for the balance of change and continuity, it owes much to King Fahd.

The quiet diplomat

KING Fahd is a doyen of world statesmen. His experience in government dates back almost fifty years. He was appointed as the first Education Minister in 1953 – the same year that he represented Saudi Arabia at the coronation of Britain's Queen Elizabeth.

He was born in Riyadh in 1923, the son of King Abdul Aziz Al-Saud, the founder of the modern Kingdom of Saudi Arabia. Fewer than 20,000 people lived in Riyadh during his childhood. The young prince was a rarity in receiving a schooling. Today, the city has a population of three million, landmark buildings and an abundance of schools and universities.

King Fahd is thus the leader of the generation that forms the bridge between the harsh and frugal life of the desert people and the modern city dwellers.

His training for the responsibilities of government began at an early age. In 1945, he was a member of the Saudi delegation to the signing of the United Nations Charter in San Francisco.

He traveled extensively across the country after his appointment as Interior Minister in 1963, gaining first-hand knowledge of its people and its diverse regions. Five years later, he also became Second Deputy Prime Minister. He often chaired the regular meetings of the Council of Ministers.

His thorough understanding of his own country is matched by his long international experience. As Saudi Arabia emerged as a country of global significance, full use was made of Prince Fahd's diplomatic skills. He led the Saudi delegation to summit conferences of the League of Arab States. He met with France's President Charles de Gaulle in 1967. Three years later, he had important discussions with the British over the future of the Arabian Gulf.

Prince Fahd paid his first official visit to the United States in 1974. He had wide-ranging talks with President Richard Nixon and Secretary of State Henry Kissinger. He also negotiated the agreement that led to the creation of the Saudi Arabian-U.S. Joint Commission on Economic Cooperation. He welcomed this as "an excellent opening in a new and glorious chapter in relations" between the two countries. Henry Kissinger referred to it as "a milestone in our relations with Saudi Arabia."



King Fahd meets George Bush at the White House

In March 1975, when Khalid Bin Abdul Aziz was proclaimed King, Prince Fahd became Crown Prince and Deputy Prime Minister. His diplomatic role deepened with the country's growing importance within the Arab, Islamic and developing worlds.

"I believe that everyone would agree that beginning when he was Crown Prince, he was able to inject Saudi Arabia into the heart of international discussion and affairs," President Jimmy Carter told MBC. "I'm not implying criticism of his predecessors, but I don't think there's any doubt that that was a turning point in the status of Saudi Arabia as a respected international player in both economics and politics."

The principles underlying King Fahd's policies were established whilst he was Crown Prince. He was, and remains, committed to the unity of the Arab world and of the wider Islamic community. His

conviction that peace must always be the goal in any conflict is matched by an equal belief that lasting peace can only be achieved through justice. Stridency achieves little but headlines. Patience is the best way to get results where they matter, on the ground. In fact, Saudi Arabia has consistently taken initiatives to try to resolve some of the most difficult problems within its sphere of influence.

King Fahd's long-standing interest in seeking an end to the Arab-Israeli conflict is strong and personal. Jimmy Carter believes that King Fahd's "major legacy" has been "to preserve peace within his own country, to hold the Arab world together, be constructive in economic relations with the outside world, including oil supply stability, and at the same time to protect the rights of Palestinians as well as possible."

The "Eight-Point Peace Plan", which Prince Fahd proposed in August 1981,



DAVID VALDEZ/ THE WHITE HOUSE, GAWMA, HEX, CORBIS

The King meets (clockwise from top center) with Britain's Queen Elizabeth, Prince Philip, and Margaret Thatcher, and Presidents Carter, Ford and Reagan

was unanimously adopted at the Arab Summit in Fez, Morocco, the following year. The plan, which became the foundation for the "Fez Declaration", envisaged a peaceful solution for a Palestinian homeland.

"Back in 1981, that was beyond the American vision," former US Ambassador Richard Murphy comments. "Well, I think history has proved him right. The package that he devised in 1981 was ahead of his time, ahead of the time for many actors on the world stage."

As Crown Prince, he also directed the domestic progress of the nation during a period of extraordinary and intense development. In particular, he played an essential part in the second and third 5-year development plans, which transformed the country's infrastructure between 1975 and 1984. It is impossible to exaggerate the scale and pace of

change. A hardy desert people, with few resources beyond themselves, saw the pattern of their life utterly redrawn. Within a generation, rural families were producing city-dwelling graduates working in high technology industries. The country itself had become a key to global energy and prosperity.

Such stresses could drive a society to violence and revolution. It is a tribute to the secure and stable system of rule that this has not happened in Saudi Arabia. There are strains, of course, but the consultation and consent on which the monarchy is founded have proved capable of coping with them. The key social cement has been the persistence of Islamic principles and values as an underpinning to dramatic material change.

Binding the country together with brand-new roads and airports was an immense task. In essence, however, it was

a matter of civil engineering. Crown Prince Fahd went beyond this in building new cities, or vastly expanding existing towns, and thus changing the Kingdom from a rural to a strongly urban society. His idea was to create centers in each region to act as prosperous focal points for services and industry.

In the countryside, he encouraged land distribution, and the creation of large-scale farming enterprises. It may seem unlikely, but the desert country has become a large-scale exporter of wheat, dairy products, fruits and vegetables. Indeed, the country can boast one of the world's largest integrated dairy farms.

It was the Kingdom's aim, he said, to combine government efforts with the understanding and cohesion of citizens in order to achieve "a prosperous society, a society well-balanced economically, culturally and intellectually, and one

based upon the teachings and spiritual values of Islam."

Prince Fahd was proclaimed the fifth King of Saudi Arabia in 1982. Prince Abdullah Bin Abdul Aziz became Crown Prince and Deputy Prime Minister, and has exerted a major influence on both domestic and foreign policy, whilst Prince Sultan Bin Abdul Aziz added the office of Second Deputy Prime Minister to his existing portfolio at Defense and Aviation.

The King set the tone of his reign in his investiture speech. He promised that it would be marked by concern for the peoples of the world, as well as for the citizens of his own nation.

"We are active, fellow countrymen, in the wider international sphere within the framework of the United Nations, its agencies and its committee," he said. "We will continue to reflect, our sense of belonging to the world community."

It is no coincidence that this most generous of men should rule one of the world's most generous nations. "We have never failed to promote the welfare of our people, as well as that of our Arab and Muslim brothers," he has said. "We have readily shared with them the fruits and riches of this country, extending our aid all over the world."

This is not an idle boast. Some 70 countries across the globe have benefited from Saudi aid. More than \$27 billion has been provided to member states of the Organization of the Islamic Conference, for example, during his reign. A further \$14.6 billion in loans has been supplied to developing countries through international and regional organizations.

On a personal level, King Fahd has helped thousands of needy pilgrims making the hajj to Makkah from his own pocket. He has actively supported the reconstruction efforts in Lebanon with

financial and other assistance. His interest has helped to ensure that billions of dollars in emergency aid has gone to the survivors of natural and man-made disasters. He has also donated funds for the restoration in Jerusalem of the Al-Aqsa Mosque, the third holiest site of Islam, and for the Dome of the Rock and Omar Ibn Al-Khattab mosques.

He has been unstinting in his diplomatic work. It has taken him on State visits to Washington, to confer with President Ronald Reagan, and to Paris and London. His efforts to help to achieve a just settlement to the Palestinian-Israeli conflict date back to his days as Crown Prince, and have persisted throughout his reign.

He has quietly used international forums, such as the League of Arab Nations and the Organization of the Islamic Conference, to help to achieve reconciliation among Arab and other Islamic nations. He initiated efforts to end the Iraq-Iran war in 1988, and helped to achieve the national reconciliation accord signed by Lebanese leaders the following year.

"I trusted him and his word, and I think he trusted me and my word," President George Bush commented on the Gulf Crisis period. "So when you are talking you are not dealing with suspicion. I was never dealing with, well, I wonder what he's really up to? He was straight as an arrow in terms of his word of honor."

At the same time, he has been responsible for stability and growth at home. Petrochemicals remain the foundation stone of the national economy, of course. The refineries at Jubail and Yanbu, on the Gulf and Red Sea coasts respectively, are among the most modern in the world.

These two cities have been created from scratch at a cost of \$32 billion over

the past quarter of a century. Many thought they would prove to be expensive follies. Today, they account for more than half the Kingdom's industrial output. Their tree-shaded residential streets, parks, mosques and social centers make them fine examples of sympathetic urban planning in a challenging environment. King Fahd had a major role in the development of the cities whilst he was chairman of the body responsible for their creation, the Royal Commission of Jubail and Yanbu.

Diversification into the non-oil industrial sector has been a characteristic of his reign. The fifth and sixth development plans of his reign, covering the from 1990 to 1999, saw an emphasis on health care, education, the non-oil economy and agriculture.

A drive is now under way to increase growth and employment through privatization and the encouragement of foreign investment. The country's vast reserves of natural gas, conservatively estimated at 200 trillion cubic feet, is fuelling the growth of a new industry. Under Crown Prince Abdullah's Natural Gas Initiative, international oil companies can invest in fully foreign-owned gas projects.

The growth in the private sector indicates that, although oil prices have recovered from their lows, the country is responding to the weaknesses in the economy exposed by the fall in revenues. The response is pragmatic, a characteristic found in King Fahd himself.

"He has done what I would regard as the two main things for any leader of any country," comments Lady Thatcher. "To uphold all that is best of the old, and to take all that is best of the new and harness it and see that people actually profit from it."



LEARNING has a special place in King Fahd's affections. "Since its inception," he has said, "Islam has stressed the importance of knowledge and thought, hence the great encouragement and honour that the scholars in Muslim countries have enjoyed over the centuries."

Four levels of pre-university education - pre-school, elementary, intermediate and secondary - cater for children up to the age of 18. The number of girls receiving primary and secondary education has grown with particular strength. This is an essential part of the overall policy of ensuring that the whole population is numerate and literate. Massive expenditure has also gone into higher education. This reflects the need to create a pool of highly educated citizens, capable of managing a complex modern economy. King Fahd has himself served as Supreme Chairman of the King Faisal

Foundation. This was established in 1976 as a global philanthropic organization inspired by Islamic values. It furthers academic and scientific knowledge through educational and award programs. More than \$270 million has been spent on global projects since its foundation.

It does not simply distribute money, however. It is based on the belief that investment in education, science and technology, and the promotion of Islamic values, can liberate people in underprivileged regions.

A focal point of the Foundation's work is the futuristic, 875-feet high, Al Faisaliah complex in Riyadh. This has shops, department stores, a five story hotel and residential apartments as well as the King Faisal Center. This huge investment, of some \$300 million, is intended to be a revenue generator for future Foundation projects.

Boosting the private sector

SAUDI Arabia is, of course, the global oil colossus. In gas, its reserves rate fourth in the world rather than first. But it remains a giant. The Natural Gas Initiative that is currently under way points to fresh openings in the once tightly state-controlled economy.

Agreements were signed in June with eight international oil companies that will invest in three large integrated gas development projects. Proposals for downstream activities include power generation, desalination, petrochemicals and oil refining. Initial investment over the next seven to 10 years are expected to be between \$20 billion and \$25 billion.

The gas will be largely used at home. The country needs more electricity and drinking water. Gas is the cleanest and best fuel for use in power stations and water desalination plants. It is also a feedstock for the large petrochemicals industry, which helps to reduce dependence on oil.

This is the leading example of the new thinking in economic policy. The slump in oil revenues in the mid-1990s made it clear that a paternalist and protectionist approach to industry was no longer viable. Although the government enjoyed a \$14.8 billion surplus last year, the lesson was learnt.

Foreign investment, privatization and a larger private sector were needed to help to meet the pressures of needed infrastructure developments and of a rising population. The progress of economic reform continued.

A foreign investment law of April 2000 gave foreigners the right for the first time to 100 per cent ownership of projects in the country. The law also reduced the tax on corporate profits from 45 per cent to 30 per cent. Foreign companies are allowed to apply for soft loans from the Saudi Industrial Development Fund. They can transfer funds from the project abroad. A one-stop shop – the Saudi Arabia General Investment Authority, SAGIA – was established for prospective investors seeking a license, and as a regulatory body.

The current five-year plan has some ambitious goals. It aims for annual growth of 3.16 per cent. This will help in the task of creating more than 325,000 jobs for Saudis inside the five years, with a further 480,000 Saudis moving into



The Kingdom Center in Riyadh: business development is concentrating on the non-oil sector

jobs now filled by expatriate workers. Major infrastructure programs are planned in power, water and telecommunications.

Foreign investment and privatization are seen as keys to growth. The private sector is expected to contribute some 70 per cent of total investment over the five years. Power demand, boosted by a rising population and industrial needs, is such that an additional 50,000 Megawatts of generating capacity is planned by 2023. The cost is estimated at \$63 billion. In the water industry, an estimated \$2.6 billion a year is required over the next two decades to boost desalination capacity. Licenses have already been issued for desalination projects.

Oil revenue alone is unlikely to be enough to pay for the huge infrastructure projects without an input of foreign investment. A flourishing private sector is also needed to generate jobs for the new entrants to the labor market. To encour-

age them to work in the private sector, efforts are being made to make private sector social security as attractive as that in the public sector.

New tax, labor and insurance laws are being studied. State-owned assets will be privatized, and regulatory bodies are being created for the power and telecommunications sectors. A decision has been reached to join the World Trade Organization. Tariff reductions earlier this year are a further sign of liberalization. Progress is being made to establish a public stock market to replace the existing interbank market. This should aid the repatriation of Saudi funds currently held abroad.

The new investment laws remove the requirement that companies based in the Kingdom must be owned by Saudi nationals. Foreign investors will benefit from a more beneficial tax regime, and overseas companies and individuals will be able to own property.



The Al Masmak palace was seized by King Abdul Aziz during his storming of Riyadh in 1902

The House of Saud

THE most important of the early ancestors of the Al Saud family was Muhammad Ibn Saud, who was born in 1710. He was a local ruler in Ad-Dar'ia who forged a political and family alliance in 1744 with the Muslim scholar and reformer Muhammad ibn Abd al Wahhab. Muhammad Ibn Saud agreed with the Imam's burning desire to revive a purer Islam in its simplest and original form. The two men took an oath in 1744 that they would work together to achieve this. Muhammad ibn Saud's son, Abdul Aziz, married the daughter of Imam Muhammad. The pact sealed between the families has lasted to the present day.

The religious zeal and fighting skill of Abdul Aziz enabled the Saudi state to spread rapidly. Within fifteen years, its

authority had extended throughout the Nejd. The city of Riyadh fell to Abdul Aziz in 1773. After his death, his son Saud ibn Abdul Aziz marched on Makkah, capturing the Holy City in 1803. The Al Saud's fervor had enabled them to extend their control to most of the Arabian peninsula.

This consolidation of power caught the jealous attention of the Ottoman Empire. Muhammad Ali, the Viceroy of Egypt, was urged to put an end to the newly emerging nation. Before Saud's death in 1814, Muhammad Ali had retaken the Hijaz. Saud's son was captured and removed to Istanbul, where he was executed. Riyadh was captured in 1818. The Ottomans maintained some garrisons in Nejd.

The fortunes of the House of Saud

then revived. In 1824, Turki, a cousin of Saud bin Abdul Aziz, became Amir of Nejd. He retook Riyadh. His successor, Faisal bin Turki, was taken captive to Cairo. He escaped after five years, however, and returned to rein control of most of Nejd and Hasa by the time of his death in 1865.

Rivalry among his sons so weakened the family that a tribal leader based in Hail, Muhammad bin Rashid, was able to take much of the Saud territory and to conclude a pact with Turkey. In 1891, Muhammad bin Rashid completed his control by capturing Riyadh, the citadel of the House of Saud. Abdul Rahman bin Faisal, who had become leader of the Al Saud family, was forced to leave the city. He lived for months with the Al-Murrah tribes in the Great Waste, in the Empty



Quarter, with his son, Abdul Aziz, the future king of Saudi Arabia. Eventually, he went into exile in Kuwait.

At age 21, Abdul Aziz - best known as Ibn Saud - determined to retake Riyadh. The task seemed hopeless. He had a force of only 40 friends. He left Kuwait in December 1901 and reached Riyadh in January. His assault on the Masmak fort and his recapture of Riyadh from Rashid is an epic of dash and daring.

Under cover of night, with his cousin Abdullah bin Jelawi and other volunteers, he scaled the walls of the city with grappling irons. Once within the walls, they moved into an empty house close to the residence of Ajlan, the Amir of Riyadh. There they waited. Ajlan came out from the mosque into the street after



King Abdul Aziz whilst unifying the country in the 1920's

dawn prayers. Abdul Aziz gave a great battle cry and rushed after the fleeing Amir, who briefly defended himself before he was cut down. The Riyadh garrison, demoralized by the death of their leader, and fearing they faced a far larger force than 40 men, surrendered. The city welcomed the return of the Al Saud.

By 1906, Abdul Aziz had regained control of the Nejd region. The Hasa region followed in 1913. The Ikhwan, a force of bedouin fighters raised by Abdul Aziz, took the Jebelshammar in 1921. Between 1924 and 1926, Abdul Aziz took Makkah, Madinah and Asir. Almost all the territory of the modern state was then unified under Abdul Aziz's authority. In 1932, he became King of Saudi Arabia.

He ruled until his death in 1953.

HULTON GETTY

Heart of Arabia

TOURISM is a new departure. Pilgrims have come to Makkah and Madinah on the hajj for almost fourteen centuries, of course, and the country is accustomed to hosting them. A Supreme Council for Tourism has now been created to develop a formal tourist industry, however. The government has improved roads, communications and power supplies in tourist areas. The private sector has responded with new resort projects with hotels, shopping centers and entertainment.

The country has vast contrasts to appeal to the eye. It has unspoiled coral reefs in the Red Sea, historic sites and ancient city souks, and cityscapes of stunning modernity. In the rock city of Madain Salah near Madinah, striking tombs were carved from solid rock by Nabatean masons 2,000 years ago.

The coastline is magnificent and unspoiled, the mountains ideal for trekking, the Empty Quarter a desert of unsurpassed majesty.

In the Asir region, on the western borders of the country, the mountains soar to over 9,000 feet before falling to 84



miles of unspoiled Red Sea beaches. The cool air at altitude already attracts 700,000 people a year from all over the Gulf. Isolated and backward a few decades ago, Asir now has five-star

hotels, 2,500 miles of modern roads, and a university famous for computer sciences and its medical school. Abha, the capital, has a luxurious hotel, a water leisure park and a 3,500 seat theatre.

Pilgrimage to Makkah

THE Saudi monarch has a unique place as the Khadim al Haramayn, or guardian of the Holy Places, and as the leader of the worldwide community of Moslems. This role is seen at its most vivid during the hajj, the pilgrimage to Makkah. This takes place between the eighth and thirteenth days of Dhu al Hijjah, the last month of the Muslim year. The hajj is one of the five "pillars", or core religious duties, of Islam. To make the pilgrimage is a lifetime ambition for those who take part in it.

King Fahd initiated a \$11 billion project to expand and improve facilities at the holy sites. The size of the Masjid Al-Haram, the Sacred Mosque in Makkah, has been almost doubled to 3.5 million square feet with space for one million worshippers. The size of the Al-Masjid Al-Nabawi, the Prophet's Mosque in Madinah, has increased tenfold, allowing it to accommodate half a million people.

Other investment has gone into airport buildings, roads, water supplies and health facilities. The government distributes bottled water and boxed lunches during the climbing of Mount Arafat. Ambulances with first-aid teams are kept in strategic places. Health education videos are shown on pilgrim aircraft and ships.

The improvements reflect the dramatic increase in the number of pilgrims arriving from outside the Kingdom. In 1965, they numbered some 300,000. By the start of the present reign, the figure had climbed over the one million mark. The number of pilgrims in 2001 was 1,804,800, of whom more than 1.3 million came from abroad.

The huge logistical and administrative challenge of coping with this annual influx is met by the Ministry of Pilgrimage Affairs and Religious Trusts. Special pilgrimage visas are issued to allow pilgrims to visit Makkah and to make the excursion to Madinah to visit the Prophet's tomb.

The pilgrims perform the rituals in the same manner as the Prophet Muhammad almost fourteen centuries ago. The haram, or holy area of Makkah, is a sanctuary. On approaching it, male pilgrims wear an ihram, made of two white seamless pieces of cloth. Women wear a white dress and headscarf. These are symbols of purification and equality. They enter the Grand Mosque surrounding the Kaaba, which contains the black stone believed to have been given to Abraham by the angel Gabriel.

They then go to Mina, on a plain outside Makkah. They pass the night in prayer and meditation. The central ritual of the hajj takes place on the Plain of Arafat. This is wuquf, or the standing. The congregation faces Makkah and prays from noon to sunset. Muhammad delivered his sermon of farewell from Mount Arafat, or the Mount of Mercy, a hill above the plain. Through wuquf, the pilgrim is joined to those who originally listened to the Prophet.

A canon is sounded at sunset. The pilgrims go to Muzdalifah, an open plain between Arafat and Mina, where they cast pebbles at one of three stone pillars that represent Satan. The pilgrims renounce evil and declare themselves willing to sacrifice all they have to God. The pilgrims now buy a sheep, camel or goat to sacrifice in imitation of Abraham. The sacrifice is repeated throughout the Islamic world as Moslems celebrate Id al Adha, the Festival of Sacrifice, the most important feast of the year. Surplus meat is given to the poor.

This section was written by Brian Moynahan, former European Editor, The Sunday Times and was sponsored by Saudi Arabia.

COMMENTARY

By Howard Gleckman

WHY STATES WILL BE A DRAG ON RECOVERY

What the feds giveth, the states may soon take away. As Washington struggles to boost the sagging economy, cash-strapped cities and states are facing enormous budget cuts and tax hikes that could drag it back down. States may be looking at a shortfall this fiscal year of up to \$50 billion. And that could neutralize as much as a third of any tax cuts and new spending in a Washington stimulus package.

Hard times hammer states because governors, unlike the President, must balance their books every year. As a weak economy slashes revenues and boosts costs for safety net programs, states must cut other spending or jack up taxes. Making matters worse, proposals in Washington to speed up corporate tax write-offs for capital investment could drain up to \$5 billion from state coffers.

Add to that the domestic war on terrorism, which has busted public-safety budgets. West Virginia Governor Bob Wise says his state police ran up 1,900 overtime hours in just one month. Even the state's one bomb dog is exhausted. "Her sniffer is wearing out," frets Wise.

In different circumstances, added spending might be a boost. After all, those state troopers are getting a lot of extra money to spend. But with states in a fiscal crunch and the feds not reimbursing security costs, every dollar for anti-terrorism must come from other programs.

MAKING DO. Governors and mayors need a helping hand. Nobel Prize-winning economist Joseph E. Stiglitz suggests the feds simply send checks to the states. Another idea: temporary grants to cover the direct costs of homeland security and recession-induced layoffs. Even conservatives, who doubt added spending can boost the economy, agree that Washington should

pay for some additional security costs. "There's a reasonable argument for that," says Chris Edwards, fiscal policy director at the libertarian Cato Institute.

The news for states hasn't been this grim since the 1990-91 recession. According to the National Conference of State Legislatures, 44 states report lower-than-expected revenues,

Massachusetts, are mulling delays in scheduled tax cuts.

The program causing some of the biggest headaches is Medicaid, which provides health care for the poor and many seniors. Washington pays about half the costs, and states pick up the rest. This year, Medicaid accounts for roughly 20% of state budgets.

Rising unemployment is sharply



GOLDEN GATE DUTY: New security measures are draining state coffers

and at least 19 face higher-than-expected costs. Massachusetts is confronting a \$1.4 billion deficit. Governor Jeb Bush is battling a \$1.3 billion shortfall in Florida. And with revenues in California more than \$1 billion below forecast, Governor Gray Davis has asked state agencies to trim budget requests by 15%.

For now, most states are trying to make do with modest spending cuts, asset sales, and rainy-day funds. But if the economy continues to stagnate, the budget ax will fall. On the likely hit lists: school and road construction and aid to the poor. And while few states are talking about raising taxes yet, several, including Florida and

boosting demand for Medicaid. Costs were expected to increase by nearly 11% even before the slump. And the Urban Institute, a Washington think tank, figures a one-percentage-point rise in jobless rolls will throw 1.5 million more people onto the program.

In Ohio, officials expected 39,500 new Medicaid patients in the July-to-October quarter, but more than 67,000 signed up. Ohio Medicaid chief Barbara Edwards says the state may have to trim services or eligibility. One way to forestall such cuts: Persuade Congress to raise temporarily the federal share of Medicaid.

Shipping cash to states is not very popular in Washington, which itself is again looking at the prospect of fiscal red ink. But by ignoring the problems now festering in the heartland, Congress and the White House will end up diluting the fiscal stimulus over which they are battling so hard.

Gleckman covers fiscal policy from Washington.

STATE OF THE STATES

Number facing lower-than-expected revenues **44**

Number where spending is over budget **19**

Number considering budget cuts **28**

Estimated total shortfall in fiscal 2002

\$50 Billion

Data: National Conference of State Legislatures, National Governors' Assn., BusinessWeek



SURVEY UPDATE

UNDER THE WEATHER

The Info Tech 100: A few still shine despite tough times

To grasp just how unsettled the stock market is these days, consider defense electronics maker L-3 Communications Holdings Inc. Even though its sales and profits have grown all year, bear-market sentiment pinched its stock. In the first eight months of 2001, L-3 shares sagged nearly 20%, reaching a 52-week low of \$60.70 on Sept. 10. Then came the terrorist attacks, and L-3—like many defense companies—surged. It's now trading near \$90, thanks to a horrifying turn of events no market sage ever could have predicted. September 11 "assured the defense budget is going to be very strong over

the next four or five or six years," says L-3 Chief Executive Frank C. Lanza. "Now the financial community values us."

Such gyrations have buffeted scores of top players in technology. Since September 11, travel companies such as Travelocity.com Inc. and Sabre Holdings Corp.—already trading lower for the year—have been hammered by a sharp drop-off in business trips. Investors are shifting instead to bellwethers such as mobile-phone giant Nokia, software powerhouse Oracle, and wireless service star Vodafone—all of which have gained 30% or more since the attacks. Even so, the picture for

the overall tech sector remains pretty darn ugly. Amid mounting evidence of a bona fide recession and doubts over recovery in 2002, tech simply isn't where nervous investors want to be.

A FIRST. That's the inescapable conclusion from the midyear checkup on *BusinessWeek's* Information Technology 100. Our annual survey of the top 100 global IT companies, published in June, ranks contenders by revenues, sales growth, profitability, and stock appreciation. Every fall, we calculate the companies' stock performance during the previous six months. This year, for the first time since we introduced the list in 1999, every

BEST OF BREED

The top performers in seven sectors:

SECTOR
TOP PERFORMER

SERVICES & DISTRIBUTORS

−5.4%

CERNER

+36.1%

TELECOMMUNICATIONS

−18.0%

ALLTEL

+12.8%

SEMICONDUCTORS

−20.1%

NVIDIA

+28.2%



THE TOP 10 PERFORMERS

RANK/ COMPANY	6 MONTHS TOTAL RETURN	12 MONTHS TOTAL RETURN	JUNE RANK
1 CERNER	36.1	-7.4	45
2 CDW COMPUTER CTRS.	29.8	-7.9	43
3 TECH DATA	29.8	11.8	53
4 NVIDIA	28.2	71.1	4
5 AFFILIATED COMPUTER SERVICES	24.3	60.5	62
6 FAIRCHILD SEMICONDUCTOR	18.2	14.6	73
7 FISERV	14.7	19.6	79
8 CADENCE DESIGN SYSTEMS	13.7	-0.7	75
9 ALLTEL	12.8	-1.5	31
10 LOGITECH INTERNATIONAL	11.9	14.1	91

Returns through Nov. 9

More rankings on page 70

ch sector shows an average decline in are prices. Four-fifths of the Info Tech 0 companies have lost value—17 of em by more than half. In total, the oup sagged 23.5% between May 9 and ov. 9, despite a sharp rally over the t month. “No question, this is the most treme cycle of the last 30 years,” says ury Unrein, the head of private equity vestment for J.P. Morgan Fleming Ast Management.

That’s not to say there haven’t en winners. Although major ck indexes fell over the past lf-year, the top 10 performers ur list posted gains of more an 10%. Even many decliners d better than the broader mart: One-third of the companies outpermed the 10.8% drop in the Standard Poor’s 500-stock index.

The best category: IT services and tributors, which grabbed 5 of the top slots. Although the group as a whole l 5.4%, it fared better than any other ctor. The No. 1 performer was Cerner rp. of Kansas City, Mo., which prodes accounting and billing software d services for the fast-growing healthre industry. With an expected \$575

million in sales next year, up 16%, Cerner is a rare tech growth story. It’s also profiting from a makeover of its product line over the last five years: Cerner spent \$350 million converting from main-frame programs to Windows-based software, giving it a jump on rivals.

That edge applies to other top performers as well. Although it’s hard to believe companies associated with the PC

could be stock champs, No. 2 and No. 3 on the Info Tech 100 update serve that battered sector. Their secret? Sticking to their knitting. No. 2, CDW Computer Centers Inc. of Vernon Hills, Ill., has prospered by selling PCs and peripherals to the growing—but underserved—small and midsize business market. And computer gear distributor Tech Data Corp. of Clearwater, Fla., No. 3 on our list, keeps a tight lid on costs and boasts industry-leading gross margins (page 68).

These stocks are benefiting from relatively bullish growth forecasts. Spending for tech services is expected to increase 10% in 2002, vs. a 3% rise in other tech spending, says researcher International Data Corp. “Outsourcing companies

actually flourish in a down economic environment,” says analyst David Grossman of Thomas Weisel Partners LLC. Such thinking has boosted other services companies such as Affiliated Computer Services and Fiserv to the Info Tech 100’s top 10.

The surprising runner-up category was telecommunications services, which fell 18% on average. Its relatively strong showing is unexpected because telecom is in turmoil, with stagnant sales, overcapacity, and crushing debt levels. What do investors like? Hold onto your hats, free-marketers: The top performer is Alltel, a Little Rock-based provider of phone service in rural areas where it’s often the only game in town. And players such as Swisscom and Teléfonos de México are quasi-

monopolies that face little domestic competition—helping them stay profitable and churn out gobs of cash.

BLEAK. Who were the big losers? No group fared worse than communications equipment makers, with contract manufacturers and software companies only slightly better off. All three sectors saw earnings fall during the past six months and face dubious growth prospects next year—a recipe that sends investors running for the exits. The worst performer: ACT Manufacturing, a contract manufacturer based in Hudson, Mass., which disappointed Wall Street on Oct. 31 with bleak third-quarter results. Its shares have fallen 92%. Says Goldman, Sachs & Co. analyst Michael Zimm, ACT’s “long-term viability is increasingly at risk” due to dropping sales and mounting debts. Ciena Corp. of Linthicum, Md., a pioneering maker of optical communications equipment, was No. 99. After holding up better than rivals all year, Ciena in August slashed 2002 projections and took a beating from Wall Street. On Nov. 12, it announced a restructuring and a 10% layoff.

Investors were particularly tough on former high-fliers. No. 98-ranked Com-

**INFO
TECH
100**

UTERS & PERIPHERALS

-23.0%

TECH INTERNATIONAL

+11.9%

CONTRACT MANUFACTURERS

-42.6%

JABIL CIRCUIT

-21.3%

SOFTWARE

-28.2%

CADENCE DESIGN SYSTEMS

+13.7%

COMMUNICATIONS EQUIPMENT

-48.6%

L-3 COMMUNICATIONS

+8.7%

verse Technology Inc. of Woodbury, N.Y., a top supplier of voice-mail systems, was a tech darling for years. But slowing telecom growth and concern that Comverse has nothing else up its sleeve turned investors off. Its stock fell 72%. The Street was equally harsh on San Francisco-based Micromuse Inc. The maker of software for monitoring network performance was golden a year ago, but slumping sales and earnings drove it to No. 97.



SHINING LIGHTS. Even in down industries, though, some companies shone. Investors are backing No. 4-ranked Nvidia Corp., which continues to churn out huge profits from its successful graphics chips for PCs and game machines. Another standout is Fairchild Semiconductor International Inc. of South Portland, Me. It appreciated 18%, compared with a 20% average decline for the 25 chipmakers in the IT 100. Fairchild makes specialized power chips used in computers and telecom gear. Not that it has had a banner year: Sales for the first nine months fell 18% and it lost \$25.5 million, vs. a \$180 million profit the year before. But compared with a 33% revenue plunge for the semiconductor business as a whole, Fairchild looks pretty good.

There are even points of light in the sickly computer industry. Peripherals-maker Logitech International, for instance, expects sales growth of 25% this year. "The strategy is to disconnect Logitech from the growth of the PC market," says CEO Guerrino De Luca. Smart move. Even as PC sales sag, analysts figure Logitech's earnings from Web cameras and wireless mice will climb 40% this year. Another gainer is Dell Computer Corp., whose share of the shrinking PC business has climbed to 14.5%, from 11.5% a year ago, according to IDC. Wall Street figures Dell's earnings will grow 17% next year, even as rivals struggle to avoid red ink.

The lesson of the Info Tech 100 update is clear. Although companies on the list have suffered, nearly two-thirds of them performed better than the Nasdaq Composite Index over the last year. That suggests they belong in such a select group. What no investor anticipates, though, are strange twists of history that can change forever the fortunes of companies—and render even the most rigorous analysis a mere roll of the dice.

By Andy Reinhardt, with Darnell Little in Chicago, Steve Rosenbush in New York, and Andrew Park in Dallas

Continued on page 70

BUCKING THE ODDS BY SLASHING COSTS

Sales of PCs are in their deepest funk in more than a decade, but that has barely bothered Tech Data Corp. The computer distributor is making a profit selling PCs, printers, and other tech gear—even as revenues fall and competitors lose money. How? Aggressive cost controls. "We've learned how to calculate the cost of serving every customer, and that has enabled us to make money in bad times," says CEO Steven A. Raymund.

This is no small feat. In the third quarter, ended Oct. 31, Tech Data's earnings are expected to be \$30 million on revenues of \$4.3 billion, according to Raymond James & Associates Inc. Sure, that's down from profits of \$47 million on sales of \$5.2 billion a year ago. But it's a lot better than rivals' results. Industry leader Ingram Micro Inc. lost \$13.3 million in its third quarter (ended Sept. 30), as its sales fell 23%, to \$5.8 billion.

Tech Data's profitability has spurred a 29.8% rise in its share price in the past six months, pushing the company to the No. 3 spot on *BusinessWeek's* Info Tech 100. "Tech Data is hitting on all eight cylinders now, even though its market and the economy are down," says Raymond James analyst Robert P. Anastasi.

RISKS GALORE. Will Tech Data run out of gas as the economy continues to sputter? Don't bet on it. A daredevil who has swum with sharks in the Caribbean and run with the bulls in Pamplona, Raymund, 46, is used to living on the edge. That's helping him manage Tech Data's two-pronged strategy of

keeping a lid on costs, while increasing high-margin businesses.

Consider his approach to client costs. His customers are corporations, smaller distributors, and retailers. If a client isn't profitable, Raymund isn't afraid to lose the business. The company measures 150 costs, from average order size to freight charges, to calculate the gross expense and margin on every account. "Quite frankly, we were losing our shirt with some clients," says Raymund. In the past two years, scores of customers that didn't measure up were shown the door or persuaded to order more efficiently—for example, making one order of \$1 million rather than 10 orders of \$100,000 each. Such moves have slashed Tech Data's expenses to 3.5% of sales—well below the 5% level of Ingram and other players, according to Wachovia Securities.

With its core PC business declining, though, cost-cutting won't be enough. So Raymund is expanding sales of higher-margin peripherals such as scanners. And to provide better service, the company is rolling out an online sales program that links clients directly to Tech Data's inventory system. This change has boosted Tech Data's ability to ship orders quickly, "and that means a lot to my customers," says Robert Molinari, president of 1st Run Computer Services Inc., a New York reseller of scanning and storage hardware.

If Raymund can please customers while controlling costs, Tech Data should stay on its feet until the bulls run again.

By Charles Haddad in Atlanta



TECH DATA

IT 100 RANK 3

CHAIRMAN AND CEO
Steve Raymund (above)

THE BUSINESS

Distributing computers and peripherals to corporations, smaller distributors, and retailers

EST. 2002 REVENUES*
\$18 billion, down 12% from 2001

EST. 2002 PROFITS*
\$130.5 million, down 27% from 2001

*Fiscal year ends Jan. 31

Data: Raymond James & Associates

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ERP Solution of the Year
in North America**

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[CRM] [PSA] [FINANCIALS] [MANUFACTURING] [DISTRIBUTION] [COLLABORATIVE COMMERCE]

How the Rest Stack Up

RANK	COMPANY NAME	6 MONTHS* TOTAL RETURN	12 MONTHS* TOTAL RETURN	JUNE RANK	RANK	COMPANY NAME	6 MONTHS* TOTAL RETURN	12 MONTHS* TOTAL RETURN	JUNE RANK
11	Swisscom	9.3	10.9	29	55	Vishay Intertechnology	-25.4	-33.4	98
12	L-3 Communications	8.7	29.7	51	56	Kyocera	-26.5	-50.0	41
13	Mobile TeleSystems	8.6	18.0	72	57	Convergys	-27.1	-35.4	71
14	First Data	8.5	46.3	36	58	Agere Systems	-27.2	NA	70
15	Electronic Data Systems	7.2	28.3	48	59	International Rectifier	-29.9	2.2	22
16	Maxim Integrated Prod.	4.8	-14.9	34	60	Nokia	-30.6	-46.2	17
17	Dell Computer	4.7	-9.3	35	61	Adobe Systems	-30.6	-65.3	67
18	Automatic Data Processing	3.1	-15.8	46	62	Celestica	-31.6	-32.7	1
19	AVX	0.1	-31.7	32	63	Lexmark International	-31.8	10.5	55
20	Teléfonos de México	0.1	8.6	13	64	Brocade Communications	-32.1	-72.9	59
21	Amphenol	-0.9	-24.2	19	65	Sun Microsystems	-32.9	-73.5	65
22	IBM	-2.2	15.3	6	66	Atmel	-33.7	-27.7	84
23	Analog Devices	-4.5	-3.5	44	67	Wipro	-35.6	-60.7	87
24	Verizon Communications	-5.4	-7.7	2	68	China Mobile Hong Kong	-36.1	-49.9	5
25	OST Systems	-6.5	-25.8	82	69	Peregrine Systems	-36.3	-14.8	90
26	Microsoft	-7.4	-8.0	27	70	Micron Technology	-37.1	-19.8	50
27	Vodafone Group	-7.5	-26.7	92	71	Macronix International	-38.0	-50.0	99
28	Asustek Computer	-7.7	-23.6	42	72	Compal Electronics	-39.0	-42.9	47
29	Ricoh	-8.6	3.4	95	73	Sabre Holdings	-41.1	-13.7	76
30	Taiwan Semiconductor	-8.6	-13.7	24	74	NTT DoCoMo	-43.7	-56.2	15
31	Telefónica Móviles	-8.8	NA	7	75	Check Point Software	-43.7	-65.3	10
32	BCE	-9.1	-12.2	37	76	Cirrus Logic	-44.5	-65.7	23
33	SunGard Data Systems	-9.8	8.8	58	77	Cap Gemini	-45.5	-58.6	39
34	Oracle	-9.8	-43.4	66	78	Sanmina	-46.9	-63.9	12
	S&P 500 Index	-10.1	-18.9		79	Siebel Systems	-47.1	-77.5	14
35	IDT	-10.9	-32.0	83	80	Power-One	-47.5	-83.8	96
36	Altera	-11.4	-18.4	61	81	Travelocity.com	-48.6	1.2	89
37	KEMET	-11.6	-30.7	38	82	Sollectron	-49.4	-66.9	21
38	Linear Technology	-13.2	-31.0	40	83	VIA Technologies	-49.8	-38.3	69
39	Hon Hai Precision Ind.	-14.7	-22.8	16	84	Itochu Techno-Science	-50.9	-78.3	74
	Nasdaq Composite Index	-15.1	-42.7		85	Infineon Technologies	-54.4	-54.9	100
40	STMicroelectronics	-16.5	-30.1	26	86	BEA Systems	-55.0	-78.8	63
41	Nidec	-16.5	-36.2	54	87	Advanced Micro Devices	-56.0	-41.0	11
42	PeopleSoft	-16.7	-29.2	33	88	DDI Corp.	-56.2	-70.8	18
43	ScanSource	-17.1	-27.1	49	89	Anritsu	-56.4	-70.4	94
44	Integrated Device Tech.	-20.3	-9.5	28	90	Extreme Networks	-56.6	-82.1	93
45	Telefónica	-20.4	-26.0	97	91	Juniper Networks	-59.1	-87.0	56
46	EPCOS	-20.6	-36.7	80	92	Tellabs	-60.9	-73.9	57
47	América Móvil	-20.8	NA	9	93	EMC	-62.2	-81.3	52
48	SAP	-21.1	-41.2	30	94	Scientific-Atlanta	-62.8	-64.3	3
49	Jabil Circuit	-21.3	-43.9	20	95	Qwest Communications	-68.8	-73.1	78
50	Plexus	-21.6	-48.4	88	96	Broadwing	-68.9	-67.1	81
51	Flextronics Intl.	-22.1	-23.1	25	97	Micromuse	-70.1	-82.5	77
52	Mentor Graphics	-23.6	-15.0	68	98	Comverse Technology	-71.5	-80.7	85
53	United Microelectronics	-24.0	-38.8	8	99	Ciena	-71.6	-80.9	60
54	Checkpoint Systems	-25.0	7.8	86	100	ACT Manufacturing	-92.0	-94.5	64

* Through Nov. 9

Data: Standard & Poor's Compustat, Bloomberg



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SQUABBLING AMONG THE RICH AND FAMOUS

After months of fighting, 12 Entrepreneurship is in trouble

San Francisco's 12 Entrepreneurship Inc. may go down as the last of the Internet highfliers. When the incubator was founded in February, 2000, it was packed with a who's who of tech. The co-founders and co-CEOs, Eric Greenberg and Halsey Minor, were super-successful Web entrepreneurs. And 12's board of directors was just as star-studded, with the likes of Gateway Inc. founder Theodore W. Waitt and Netscape Communications Inc. co-founder Marc Andreessen.

What's more, despite 12's being little more than an idea, investors—including Goldman Sachs, Benchmark Capital, and former Vice-Presidential candidate Jack Kemp—couldn't shovel money in fast enough. The company, which was launched with about \$30 million, was able to raise an additional \$100 million from investors by June—even as the appetite for anything Internet had already waned. 12's value then: \$700 million. "This was the dream team," says Ronald C. Conway, a well-known angel investor who put \$1.5 million into 12 at the June valuation. "Everyone was saying you couldn't get a sweeter deal."

Seventeen months later, the situation is decidedly more sour than sweet. Greenberg is no longer co-CEO, having been ousted by the board in November, 2000, after months of conflict with Minor. Andreessen resigned last December. Investors close to the board say he disapproved of how Greenberg's departure was managed. Now, Conway and a handful of other shareholders, in-

cluding Andreessen, are leading a nasty battle with 12 to get their money back.

They may soon get their way. According to an investor near the negotiations, the board is close to approving a plan to give much of 12's remaining \$78 million back to investors. The move would effectively shut down 12. Minor will only say a resolution has been reached that should make all parties happy. Waitt says, "Something different will happen and does need to happen. But it's a difficult process."

That such a public battle could break out in clubby Silicon Valley is, perhaps, more a sign of the times than anything else. With the economy tanking and tech investments out of favor, companies born at the peak of the bubble are taking the biggest lumps. Their inflated valuations, along with sky-high expenses incurred during more frothy times, are turning once-friendly comrades into snarling enemies. "The biggest problem we have is that we raised money at a very high valuation," concedes Minor. "We all want our money back from our investments in the last 2½ years."

BIG SPENDERS. Disgruntled investors say their beef is about much more than high valuations. It starts with the belief that the business model of a tech incubator is broken. Incubators were established in the '90s to provide money to startups, plus real estate and management expertise. But all the early incubators, including CMGI and idealab, have crashed to earth. Conway and his supporters also claim that 12's shareholders

haven't been adequately informed about pivotal events such as Greenberg's departure. And they say 12 has spent recklessly on everything from extravagant offices to salaries of as much as \$500,000. As one disgruntled investor puts it: "This company screams 1999."

In early 2000, that was the perfect draw. Greenberg, who founded e-commerce consultancy Scient Inc., joined with Minor, known for online-content company CNET Networks Inc. The duo oversaw a firm that funded and helped build cutting-edge Web startups. 12's ranks swelled to 60 employees, and a satellite office was opened in New York. Executives quipped that 12 would be a component of the Dow Jones

THE LAST OF THE INTERNET HIGHFLIERS



FEBRUARY, 2000 CNET founder Halsey Minor and Scient founder Eric Greenberg

create 12 Entrepreneurship, an incubator for Web startups. The firm raises \$30

million from the co-CEOs and outside investors

FEBRUARY, 2000 12 pours \$10.4 million into Grand Central Networks, a Web services software maker. And it invests nearly \$14 million in iBuilding, a Web-services

outfit focused on real estate.

JUNE, 2000 12 raises additional \$100 million at a valuation of \$700 million. Investors include Gateway



founder Ted Waitt, eBay founder Pierre Omidyar, Netscape co-founder Marc Andreessen.

NOVEMBER, 2000 After months of fighting be-





CEO MINOR: Battling a group of angry investors who want their money back

dustrial average within a decade. But almost from the start, the relationship between Greenberg and Minor as troubled, according to former employees. Pet projects that one partner led, the other one didn't. Minor and Greenberg declined to give further details about their differences. But a former employee said it got so bad that they rarely held meetings together since each could try to one-up the other. Both also averted a lot, making the scheduling of meetings even harder. Indeed, 12 went for six months in its early days before its board had its first powwow.

Halsey and Greenberg, board approves plan to Minor sole CEO. Soon Andreessen resigns the board.

2001 12 proposes giving its corporate structure to get better tax treatment. It also reduces rights of the shareholders, who

By fall, 2000, according to sources close to the board, Minor and board member David Beirne, a general partner at Benchmark, were trying to find a way to gracefully remove Greenberg. Negotiations led to a proposal, approved by the board, that had Minor staying on as CEO and personally buying \$8 million worth of Greenberg's stock in 12. Greenberg says the situation was "dysfunctional." Minor says the move to one CEO was necessary to run the company effectively.

Although the CEO situation was resolved, insiders say Andreessen was unhappy. An investor close to the board says he felt that board members, other than Beirne, weren't as informed as they should have been about such a critical decision. Andreessen resigned from the board in a huff. Minor and other board members say the six-member board was involved in everything concerning Greenberg, and shareholders were told as soon as a resolution was reached. "The process that the board and management followed was one of being sensitive to shareholders and to their obligations," says board member Jeffrey Edwards, a general partner at JGE Capital Management.

BAD TIMING? This year, 12 scaled back its ambitious agenda. In February, 2001, 12 shut down its 15-person New York office. It also reduced its expected number of investments. Says Minor: "I was willing to change based on the environment."

Not enough to satisfy investors like Conway. As an August board meeting approached, they badgered 12 for more financial data. They asked why \$45 million in office lease commitments for 60,000 square feet had been made. They wondered why more than \$13 million had been spent on swanky furnishings and tech equipment. And they asked about the exorbitant salaries. "They aren't losing money because the market is bad," argues Conway, co-founder of Angel Investors. "They are losing money because they're wasting it."

While Minor doesn't dispute the figures, he says the allegations of waste are ridiculous. Much of the problem, he says, stems from bad timing. When the lease was signed in early 2000, he says 12 got a below-market deal because it

allowed the landlord to invest in 12. He says the office improvements were in keeping with what other companies spent. And Minor, who personally earns just \$1 a year and has sunk \$22 million of his own cash into 12, says the salaries are what the market requires for top talent. If he were squandering funds, he adds, much of it would be his own.

The warring factions got so contentious that when Conway asked to visit 12's offices in late August, the company's general counsel, Stuart Fagin, denied the request at management's direction. In an Aug. 27 e-mail to Conway, he wrote: "You will not be allowed past the security guards and will be asked to leave." Minor concedes the denial was a mistake and that he later invited Conway to his offices.

Seeking a truce, Minor allowed Conway and three other investors to make a 30-minute presentation to the board at its Aug. 31 meeting. The group, representing about 15% of the shareholders who put \$100 million into the company, aired their concerns and asked the board to consider folding 12 and returning the money to shareholders, according to a document prepared for the meeting.

Since then, 12 has taken drastic measures. In October, it shuttered iBuilding Inc., a Web-services firm it had financed in early 2000. On Nov. 1, the incubator laid off half of its 60-person staff. Minor and board members say the moves were motivated by economics, not Conway and his group. Since venture capital is so scarce, 12 will need to finance its companies longer. That means it will have less money for new deals and so need fewer people. "At the end of the day, we're doing what is right," says Waitt.

It would seem that the end of the day is near. Soon 12 is expected to announce details for its future—and those of its two remaining portfolio companies. While the two startups are likely to get more funding, 12 probably will not. Instead, it may come to represent the end of an era. "[12] is the final supernova," says one shareholder. "It's the last blowout because no one will ever raise that kind of money for this kind of thing again." Until the next bubble, that is.

By Linda Himmelstein in San Mateo, Calif.

protest and question 12's spending and management.

AUG. 31, 2001 At a board meeting, Ron Conway and other critics ask for their money back and for 12 to shut down, citing excessive



spending. They point to a \$45 million office lease and \$13 million spent on improvements such as fancy offices.

OCT. 8 iBuilding is shut down. Investors are told the upstart could not find outside funding after the September 11 tragedy, despite having real customers.

NOV. 1 12 lays off half of its 60 employees, cutting personnel overhead by an estimated 55%.

NOV. 9 12's board meets to weigh the future of the incubator and its portfolio companies. Discussion also includes whether to return money to shareholders.

COMMENTARY

By Aaron Bernstein

ALREADY, A CRUSH AT THE SOUP KITCHENS

Even in the best of times, the U.S. has millions of low-income families that face a financial emergency at some point during the year and take the humiliating step of going to a soup kitchen or food pantry for help. Now, an exhaustive study by America's Second Harvest, a non-profit that supplies much of the nation's emergency food aid, estimates that the ranks of hungry Americans will jump to 23.3 million this year, up 9% from the Chicago group's last survey in 1997.

The survey, released on Nov. 14, offers grim news about the slowing economy's impact on the poorest Americans. It suggests that the pain at the very bottom of society started almost as soon as economic conditions began to deteriorate last fall. And prospects are likely to worsen if the economy continues to sink. That's because those who are likely to need food aid tend to be in vulnerable groups, such as single mothers and minority women—who have been particularly hard hit by rising layoffs this year.

The findings should spur policymakers in Washington into action. For one thing, the economic stimulus package tearing up Congress can still be tilted more toward low-end families. One option: giving payroll tax rebates to families who were too poor to qualify for the income tax refund most Americans received earlier this year.

CANARY'S WARNING. Congress also may need to accelerate reconsideration of the 1996 welfare reform law, which comes up for renewal next year. Those reforms did wonders in bringing down welfare rolls in a booming economy. But if hunger is already climbing when the jobless rate remains relatively low, today's strict limits on how long mothers can collect welfare may cause huge problems if unemployment rises. "Hunger is like the canary in the mine shaft,"

says Second Harvest research director Douglas O'Brien. "It goes up right away, even before food stamps or welfare."

Clearly, the new findings are troubling. The Second Harvest survey, a comprehensive sample of 32,000 individuals, accounts for everyone get-

the effects of the rise in joblessness that began last November.

It's no surprise, then, that many of the people showing up for food aid are also among the newly jobless this year. The overall unemployment rate has jumped by 1.5 percentage points in the past year, to 5.4%, as of Octo-

ber. In contrast, the rate for black women 20 years and older has jumped by 3.1 points, to 8.9% in October, while the rate for black men in that age group climbed by only 1 point, to 8%, according to the Bureau of Labor Statistics. Hispanic women over 20 show a similar pattern: a 2.2-point jump, to 7%—double the increase for Hispanic men. While the BLS data don't break out jobless rates for those in the likely welfare population,

black and Hispanic women comprise a majority of that group as well. And they are the ones most likely to work in the marginal, low-wage service jobs that are so vulnerable in the slowdown.

Rising unemployment quickly results in more hunger because many of the poor live so close to the edge. The bottom fifth of households had average aftertax incomes of just \$8,761 a year in 1999, the last year available, according to the Economic Policy Institute, a Washington think tank—nearly half the national poverty rate for a family of four. Those who ask for emergency food aid "are the poorest of the poor," says Mark Nord, who's in charge of the Agriculture Dept.'s hunger survey.

At that level, even a handful of lost paychecks can be enough to drive families into begging for help. Unless steps are taken to shore up the very bottom, millions more Americans could be standing in line for their next meal.

Bernstein covers social policy from Washington.



LIVING ON THE EDGE

*Number of people getting emergency food aid**

YEAR	1993	1997	2001
MILLIONS OF PEOPLE	20.7	21.4	23.3

*Excludes repeat users

Data: Second Harvest

ting food from the 36,000 food pantries, soup kitchens, and homeless shelters across the country to which the organization funnels food. Nearly 40% of all recipients are children under 18. Of the adults, 62% are women, 55% are minorities, and 23% are single parents.

Hunger fell in the booming economy of the late 1990s, which provided more jobs and fatter paychecks to even the lowest-income families. Indeed, the Agriculture Dept.'s annual hunger survey showed slight declines through 1999, the last year available. (The 2000 statistics are due out in the next month.) But, in polling food recipients from January to April of this year, Second Harvest's study captured

Software quality ↑ 80%

Developer productivity ↑ 300%

ROI ↑ 1400%

Testing time ↓ 95%

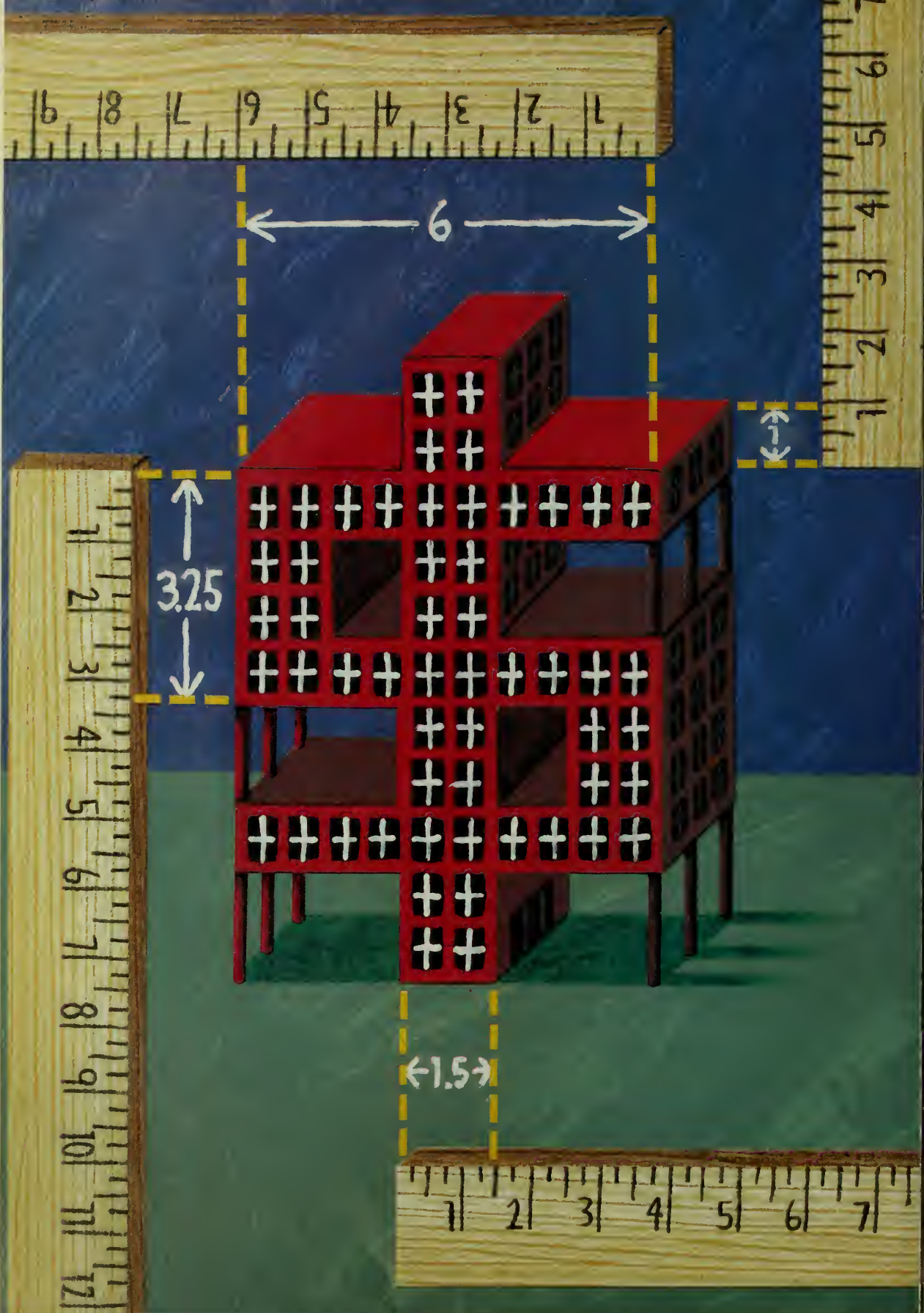
Development cycle ↓ 66%

Lump in throat ↓ 100%



Lies, damn lies and statistics, you say? Some of our customers used to be cynical, too. Before they were customers. But then they started sending us these numbers. Telling us that the results of using our best practices, integrated tools and services exceeded their expectations. Cutting test time, decreasing development cycles and reducing bugs. Freeing their teams from the obstacles that hinder software development. Need more evidence? There's plenty available at www.rational.com/customersuccess4.

be liberated



CONFUSED ABOUT EARNINGS?

You're not alone. Here's what companies should do
— and what investors need to know

BY NANETTE BYRNES AND DAVID HENRY

In an age when giant earnings write-offs have become commonplace, it's hard to shock Wall Street. But on Nov. 8, Enron Corp. managed to do it. After years of high-octane growth that had seen earnings surge by up to 24% a year, the Houston-based energy company acknowledged that results for the past three years were actually overstated by more than a half-billion dollars. It was confirmation of investors' worst fears. Three weeks earlier, Enron had announced a big drop in shareholders' equity, sparking fears that its hideously complex financial statements were distorting its true performance. Management pointed to a number of factors, including a dubious decision to exclude the results of three partnerships from its financial statements and a billion-dollar error several years earlier that had inflated the company's net worth.

Enron may be an extreme example of a company whose performance fell far short of the glowing picture painted by management in its earnings releases, but it is hardly alone. This year, Corporate America is expected to charge off a record \$125 billion, much of it for assets, investments, and inventory that aren't worth as much as management thought (chart, page 79). Even if companies don't go back and restate earnings, as Enron is doing, those charges cast doubt on the record-breaking earnings growth of the late '90s.

Not since the 1930s has the quality of corporate earnings been such an issue—and so difficult for investors to determine. There's more at stake than the fortunes of those who bought shares based on misleading numbers. If even the most sophisticated financial minds can't figure out what a company actually earns, that has implications far beyond

Enron. U.S. financial markets have a reputation for integrity that took decades to build. It has made the U.S. the gold standard for financial reporting and the preeminent place to invest. It has also ensured ready access to capital for U.S. corporations. That a company such as Enron, a member of the Standard & Poor's 500-stock index and one of the largest companies on the New York Stock Exchange, could fall so far so fast shows how badly that gold standard has been tarnished. "The profession of auditing and accounting is, in fact, in crisis," says Paul A. Volcker, former chairman of the Federal Reserve and now one of the leaders of the International Accounting Standards Board.

Sometimes, as in the case of Enron, fuzzy numbers result from questionable decisions in figuring net earnings. More often, though, the earnings chaos results from a disturbing trend among companies to calculate profits in their own idiosyncratic ways—and an increasing willingness among investors and analysts to accept those nonstandard tallies, which appear under a variety of names, from "pro forma" to "core." (Enron offers its own such version. Before investors untangled the importance of Enron's first announcement, its stock rose briefly because it told investors that its "recurring net income" had met expectations.) The resulting murk makes it difficult to answer the most basic question in investing: What did my company earn?

Why calculate a second set of earnings in the first place? Because the numbers reached by applying generally accepted accounting principles (GAAP) are woefully inadequate when it comes to giving investors a good sense of a company's prospects. Many institutional investors, most Wall Street analysts, and even many accountants say GAAP is irrelevant. "I don't know anyone who uses GAAP net income anymore for anything," says Lehman Brothers Inc. accounting expert

Cover Story

ILLUSTRATIONS BY GENE GREIF

Robert Willens. The problem is that GAAP includes a lot of noncash charges and one-time expenses. While investors need to be aware of those charges, they also need a number that pertains solely to the performance of ongoing operations.

That's what operating earnings are supposed to do. But because they're calculated in an ad hoc manner, with each company free to use its own rules, comparisons between companies have become meaningless. "No investor—certainly not any ordinary investor—can read these in a way that's useful," says Harvey L. Pitt, chairman of the Securities & Exchange Commission. The SEC is examining whether new rules are needed to clarify financial reports and perhaps restrict use of pro formas.

What's badly needed is a set of rules for calculating operating earnings and a requirement to make clear how they re-

Cover Story

late to net income. In the end, investors need two numbers—a standardized operating number and an audited net-income number—and a clear explanation of how to get from one to the other.

"OUT OF HAND." A widespread consensus is building to do just that. In early November, S&P proposed a set of rules for companies to follow when tallying operating earnings. Only the week before, the Financial Accounting Standards Board, the rulemakers for GAAP, had announced that they, too, would be taking up this issue. Voleker says the International Accounting Standards Board is also seeking a uniform definition of operating earnings.

"Over the past two or three years, the use of creative earnings measures has grown and grown and grown to the point where it has really gotten out of hand," says David M. Blitzer, S&P's chief investment strategist. "Earnings are one of the key measures that anybody looks at when they're trying to evaluate a company. If people want to use an operating-earnings measure, we better all know what we're looking at."

Without those standards in place, the gap between earnings according to generally accepted accounting principles and earnings according to Wall Street is only going to grow wider and more confusing. Look at the variance in earnings



per share calculated for the S&P 500 for the third quarter: It's \$10.78 according to Wall Street analysts as tallied by Thomson Financial/First Call, \$9.17 according to S&P, and \$6.37 according to numbers reported to the SEC under GAAP. (S&P, like *BusinessWeek*, is owned by The McGraw-Hill Companies.)

The lack of a standard measure can be costly to those who choose wrong. Use First Call's earnings for the past four quarters and you get a relatively modest price-earnings ratio of 23 for the S&P 500. But run the numbers using GAAP earnings, and suddenly the market has a far steeper p-e of 38.

HIGH-GLOSS GLOSSARY

Companies are using a variety of accounting practices to put the best spin on their results. Here's what those terms mean:

DEFINING EARNINGS

NET INCOME The bottom line, according to generally accepted accounting principles (GAAP). Sometimes called "reported earnings," these are the numbers the Securities & Exchange Commission accepts in its filings.

OPERATING EARNINGS An adjustment of net income that excludes certain costs deemed to be unrelated to

the ongoing business. Although it sounds deceptively like a GAAP figure called "operating income" (revenue minus the costs of doing business), it is not an audited figure.

CORE EARNINGS Another term for operating earnings. Neither core nor operating earnings are calculated according to set rules. They can include or exclude anything the preparer wishes.

PRO FORMA EARNINGS

The 1990s term for operating earnings. Popularized by dot-coms, it sometimes excludes such basic costs as marketing and interest.

EBITDA Earnings before interest, taxes, depreciation and amortization. The granddaddy of pro forma, it was initially highlighted by industry that carried high debt loads, such as cable TV, but has since come to be widely qu-

THE COMPANIES

The dot-com boom accelerated a nasty trend: Companies making up their own ways to calculate earnings until they find one that shows profits

How did we get into this mess? Investors and analysts have been calculating operating earnings for years, and for years, reasonable people could more or less agree on how to do it. Then came the dot-com bubble, along with increased pressure from Wall Street for companies to meet their quarterly earnings forecasts. Suddenly, companies that hadn't turned a profit by any conventional measure started offering ever more inventive earnings variants. These customized pro forma calculations excluded a grab bag of expenses and allowed upstart companies to show a profit. **"TOWER OF BABEL."** Pro forma formulas vary wildly from company to company and even from quarter to quarter within the same company, casting doubt on their validity. And these days, the gulf between net earnings and pro forma earnings is wider than ever: S&P's tallies fall between the two: S&P's numbers are more systematic than pro forma, but they aren't followed widely enough to be a standard. "Investors are facing a Tower of Babel," says Robert K. Elliott, former chief of

the American Institute of Certified Public Accountants (AICPA) and a retired KPMG partner. "It's not standardized, and the numbers are not audited."

That makes it tough to evaluate a company's performance. In the quarter ended on Sept. 30, Nortel Networks Corp. offered shareholders at least three earnings numbers to choose from. By conservative GAAP accounting, the telecommunications giant lost \$1.08 a share. The company also provided two possible pro forma options: a 68¢ loss that excluded "special charges," including some acquisition costs and restructuring

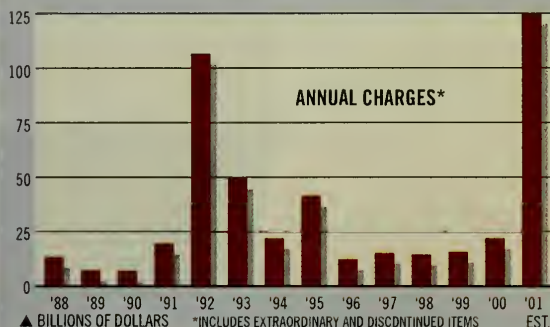
charges, and a still better 27¢ loss that further excluded \$1.9 billion of "incremental charges," such as writing down inventories and increasing provisions for receivables. Wall Street chose the rosier one.

Confusing? You bet. Companies defend their pro forma calculations by pointing out that they're merely filling a void: Investors are clamoring for a measure that gives them better insight into their company's future. The goal is to get to the core of the business and try to measure the outlook for those operations. "There are good reasons why there is an emphasis on operating earnings," says Volcker. "It is an effort to provide some continuity and some reflection of the underlying progress of the company." Besides, as companies like to point out, they still have to report GAAP earnings, and investors are free to ignore everything else.

There's no starker lesson in the shortcomings of GAAP than the \$50 billion asset write-downs by JDS Uniphase Corp., the biggest charge of the year. Near the height of the telecom bull market in July, 2000, the San Jose (Calif.) maker of fiber optics topped off a buying spree by acquiring competitor SDL Inc. for \$41 billion in stock. When the deal closed in February, its assets ballooned from \$25 billion to \$65 billion. But by then, shares of JDS and other fiber-optics makers were collapsing. To bring its acquisitions into line with their

THE BIG BATH

Companies are cleaning up their books with record charge-offs



Data: Morgan Stanley Equity Research

new value, the company took charges of \$50 billion. Despite the fact that the bulk of its losses stemmed from stock transactions and involved no cash paid, GAAP required that the charges be taken out of net income. So according to GAAP, JDS lost \$56 billion in the fiscal year ending in June—a staggering figure for a company whose revenues over the past five years added up to only \$5 billion.

Analysts and the company argue that besides not involving cash, the charge-off was all about the past, a right-sizing of values that had gotten out of hand. To analyze the company's

TED EARNINGS
term for pro forma.

FINING COSTS

AL CHARGES A term for anything any wants to highlight and therefore excluded from future projections.

IMPAIRMENTS

taken to bring some company paid a high down to its current

market value. Many companies are now taking these charges on internal venture-capital funds that bought Internet and other high-tech stocks at inflated prices.

GOODWILL IMPAIRMENTS

The same idea as asset impairments except they're used to write down the premium a company paid over the fair market value of the net tangible assets acquired. These charges will explode

in the first quarter of 2002 because of a change in mergers-and-acquisitions accounting that eliminates goodwill amortization and requires holdings to be carried at no more than fair values.

RESTRUCTURING

RESERVES An accrued expense (not usually cash) to cover future costs of closing down a portion of a business, a plant, or of firings. These are projected costs and if

overstated can later become a boost to earnings as they are reversed.

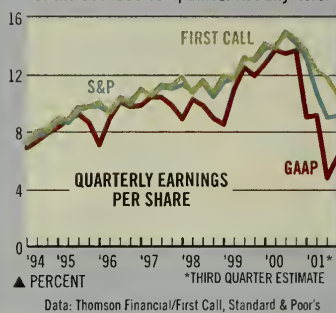
WRITE-DOWN Lowering the

value of an asset, such as a plant or stock investment. It is often excused as a bookkeeping exercise, but there may have been a real cost long ago that now proves ill spent, or there may have been associated cash costs, such as investment-banking fees.

prospects, they excluded the \$50 billion charge. "The accounting is not designed to make things look better but to describe what happened," says JDS Uniphase Chief Financial Officer Anthony R. Muller, "and we'll live with the consequences, whatever they are." Analysts make a similar defense. "My goal is to figure out what the business is going to produce so that we can value the company," says Lehman Brothers analyst Arnab Chanda.

GLACIAL PACE. Are JDS's pro forma numbers realistic—a fair gauge of JDS's ongoing operations? Right now, it's hard for investors to judge. And that's the kind of ambiguity S&P and others would like to eliminate. In November, S&P circulated a memo on how to standardize operating earnings. Under the proposal, operating earnings would include the costs of purchases, research and development, restructuring costs (including severance), write-downs from ongoing operations, and the cost to the company of stock options. It would exclude merger-and-acquisition expenses, im-

EARNINGS CHAOS
First Call, Standard & Poor's, and generally accepted accounting principles (GAAP) used to yield fairly similar results for the earnings of the S&P 500 companies. Not anymore.



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pairment of goodwill, litigation settlements, and the gain or loss on the sale of an asset.

When S&P applied roughly that formula to JDS Uniphase, it split the difference between Wall Street and GAAP. Because of differences in what each group included in their earnings calculations, the results were chaotic. Using GAAP, the com-

pany lost \$9.39 a share. S&P figures lost \$3.19, while the company put the loss at 36¢. Meanwhile, Wall Street says it made 2¢.

The S&P standard may make sense but it raises the question: Where is the Financial Accounting Standards Board the group in charge of GAAP? Chairman Edmund L. Jenkins says FASB will be addressing the problems. Still, investors shouldn't expect any improvement soon. The pace of change at FASB tends to be glacial. It typically takes four years to complete a new standard. In 1996, for example, the board realized that standards on restructuring charges had some big loopholes and it resolved to put the issue on its agenda. In June, 2000, the board finally issued a draft of a new standard, asked for comments, and held

a public hearing. In October, 2001, the board said it still wasn't ready to put a fix in place. Now, the recession has set off another wave of restructuring charges, and the FASB still doesn't have new rules.

The slow pace means the standard-setters sometimes fail to react to sudden changes in the market. The most recent failure followed the terrorist attacks on September 11. An FASB task force, unable to come up with a set of rules for separating September 11 costs from general expenses, instead told companies that the disaster could not be treated as an extraordinary item. So GAAP earnings include costs stemming from the disaster as part of a company's general performance. Many companies have nevertheless broken those costs out in their unaudited press releases.

Many more are likely to do so in the fourth quarter. Indeed, 2001 is shaping up to be one for the record books. A poor economy and the devastating aftereffects of September 11 have resulted in a slew of unusual charges that are unlikely to recur and that no one could have foreseen. But there's a growing concern that the earnings fog is providing managers with cover to hide missteps of the past within that vast category of supposedly one-time charges. The temptation will be to take as big a charge as



THE ANALYSTS

It's their job to give investors the real story. Yet they often accept flaky earnings formulas companies concoct

NAVIGATING THE NUMBERS

There's plenty of information in a company's financial statements that can help determine the company's prospects. Here are the things accountants, analysts, and other financial sleuths focus on in their reviews.

THE EARNINGS PRESS RELEASE

1. This is a document to be read with great caution. If an earnings number is flagged in the headline, it may or may not be calculated according to conservative rules. Because these statements are not reviewed by regulators, they are largely public relations efforts. If management has included a pro forma number, be sure to read carefully for information about the charges a company is choosing to ignore. "We never use pro forma numbers," warns investor Cliff Asness of AQR Capital. "I believe 'pro forma' is usually just a fancy word for lying." But announcements of other news may be very useful. A change in auditor, outside legal counsel, or the CFO makes analyst Howard Schilit's list of "10 excellent clues to detect shenanigans."

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Other income (expense) - net	(318)	200	
Interest expense			
Long-term debt	(54)	(22)	(138)
Net increase (decrease)	(23)	(17)	(69)
Cash and cash equivalents at beginning of period - net			1,758
Cash and cash equivalents at end of period - net		\$ 3,355	\$ 1,758

THE STATEMENT OF OPERATIONS

2. Here's where you will find earnings as calculated by CPAs—net income. Also, there are useful line items such as "investment income," which highlight how much money a company earned on its investment portfolio. Depending on the company, this may or may not be central to their success. Although investors tend to focus on the bottom line, the first item on the income statement—revenue—can sometimes be the most important. If it's hard to get a handle on the quality of a company's earnings, it may be easier to ascertain whether its revenue growth is slowing or increasing.

See notes to unaudited consolidated financial statements.

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Accounts receivable (less provisions of \$400 for 2000, \$319 for 1999)	\$ 1,644	\$ 2,153
Inventories	8,198	5,808
Deferred income taxes - net	4,336	2,663
Other current assets	730	826
Total current assets	1,622	682

36

THE STATEMENT OF CASH FLOWS

3. This is rarely tacked on to the press release and usually can be found only in the quarterly report filed with the SEC about a month later. It's the most conservative measure of a company's health—how much cash its operations are creating every quarter. "Short of fraud, cash flow is much less vulnerable to manipulation" than earnings, says RL Renck's Robert Renck. It's broken into operating cash flow (money in the door), cash invested in the business, and cash from financing activities, such as issuing stock or debt.

THE BALANCE SHEET

4. "People need to be looking at something they haven't been looking at for the past few years—the balance sheet," says former SEC chief accountant Lynn Turner. The balance sheet is prepared according to GAAP and highlights a company's cash on hand as well as what it has borrowed (liabili-

ties), what it has yet to be paid for (receivables), and how much inventory it has on hand. If receivables or inventory are growing much faster than revenue, it's a warning sign that demand may be weakening. A company with plenty of ready cash can invest in its future growth, perhaps by making an acquisition or funding research and development.

THE FOOTNOTES

5. These can be found in SEC filings, some only in the annual report. Look for the footnote on the pension fund to see how much of net income may have come from its gains. In the bull market of the late '90s, that was an inflator at companies such as GE and IBM. Now, the issue may be shortfall. There's also a special note devoted to restructurings and how much money has been spent on layoffs and facility closings. Look for the word "reversals." This indicates that the company overestimated how much it would have to spend and has fed that excess back into earnings.

THE REGULATORS

"An investor can't know what's been left out, why it's left out, or how it compares" with other companies, says SEC Chairman Pitt

puter Corp. is a good example of this "heads I win, tails you lose" school of accounting. For years Dell benefited from gains in its venture-capital investments and was happy to include those gains in its reported earnings, where they appeared as a separate line on the income statement. But this year, when those gains turned to losses, the computer maker issued pro forma numbers that excluded that \$260 million drag. Dell spokesman Michael Maher says the company's press releases and SEC filings break out investment

income and give GAAP numbers as well as pro forma. "In our view, the numbers are reported clearly," says Maher. "It's all out there for the consuming public."

PAST PUFFERY. Many experts believe special charges are a sign that past performance was exaggerated. What should investors make of a company such as Gateway Inc.? Two restructuring charges in the first and third quarters, minus a small extraordinary gain, totaled \$1.12 billion, or about \$100 million more than the company made in 1998, 1999, and 2000 combined. Which is the truer picture of its performance and potential? The write-offs or the earnings? Write-offs for customer financing are another example. When Nortel increased its reserves for credit extended to customers by \$767 million in September, it effectively admitted it had booked sales in the past to companies that couldn't pay—in effect overstating its performance in those earlier periods. In addition, Nortel says booking sales and accounting for credit are unrelated issues. Tech companies blame the sharp downturn in their industry for the big write-offs. And these aren't isolated examples. Peter L. Bernstein, publisher of newsletter *Economics & Portfolio Strategy*, found that from 1989 to 1993, 20% of earnings vanished into write-offs.

Big charge-offs can also distort future performance. Critics contend that excess reserves are often used as a sort of "cookie jar" from which earnings can be taken in future quarters to meet Wall Street's expectations. Or charges taken this year, for example, which is apt to be a lousy one for most companies anyway, might include costs that would otherwise have been taken in future periods. Prepaying those costs gives a big boost to later earnings. Rules for figuring operating earnings would help, but this is an area that will always involve a certain amount of judgment—and therefore in-



possible now, while investors are braced for bad news. Not only can managers sweep away yesterday's errors, but tomorrow's earnings will look even better.

The basic question comes down to what constitutes a special expense—a charge so unusual that to include it in the earnings calculation would be to distort the truth about a company's performance. Usually, big charges fall into a few categories, including charges for laying off workers and restructuring a company, charges for assets that have lost value since they were purchased, charges for investments that have lost value, and charges for inventory that has become

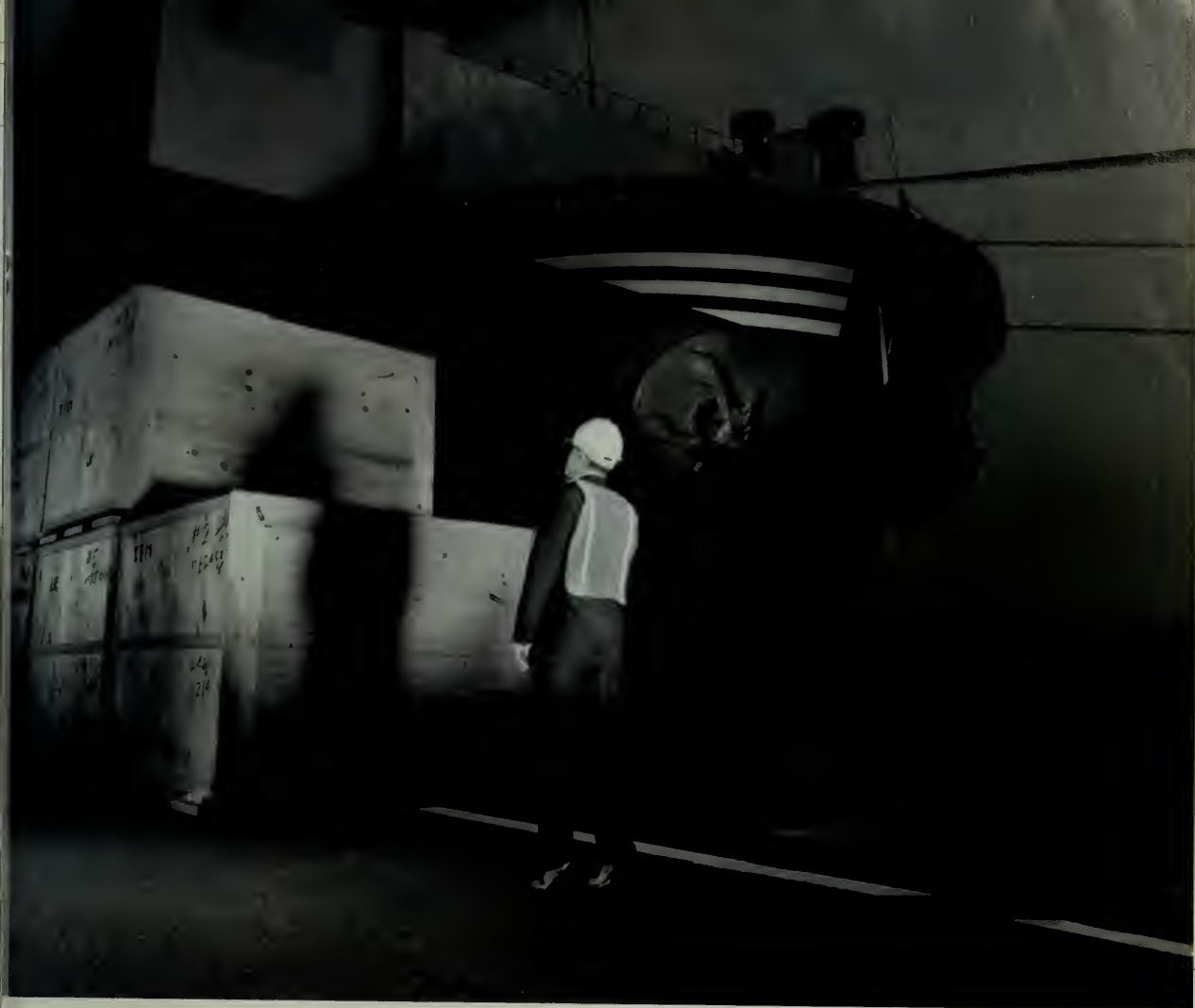
obsolete. In a recent study, Harvard Business School professor Mark T. Bradshaw

Cover Story

found that companies are increasingly calling these charges unusual. That gives them a rationale for excluding them from their pro forma calculations.

Lots of critics disagree, saying such charges are often an inevitable part of the business cycle and should be reflected in a company's earnings history. They certainly should not be ignored by investors. "Charges are real shareholder wealth that's been lost," argues David W. Tice, manager of the Prudent Bear Fund, a mutual fund with a pessimistic bent that's up 17% so far this year. "It's money they spent on something no longer worth what it was, a correction of past earnings, or a reserve for costs moving forward. Whatever the reason, it's a real cost to the company, and that hurts shareholders."

Without standards, excessive write-offs from operating earnings can obscure actual performance. Without any rules, companies calculate operating earnings inconsistently in order to put their companies in the best possible light. Dell Com-



A SHIPMENT OF PLASTIC IS MISSING IN THAILAND. SO A FACTORY STOPS WORK IN PARIS.

AND A CEO GOES SLEEPLESS IN CINCINNATI.)

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vite a certain amount of abuse. "People are going to write off everything they can in the next two quarters because they're having a bad year anyway," says Robert G. Atkins, a Mercer Management consultant.

Part of the lure of big special charges is that investors tend to shrug them off, believing that with the bad news out in the open, the company is

poised for a brighter future. Since Gateway detailed its third-quarter charge of \$571 million on Oct. 18, Wall Street has bid the stock up 48%, compared with a 6% runup for the S&P 500.

Often, though, investors should take exactly the opposite message. If, for example, part of a restructuring involves slashing employee training, information-technology spending, or research and development, the cuts could depress future

member controllers and financial officers found that at least third expect to take more charges.

But figuring out the proper value of those assets is no easy task. Unless there is a comparable company or factory with an established market price, valuing them involves a lot of guesswork for which there are no firm rules. "What this is really coming down to is corporations and their auditors coming up with their own tests for impairment," says the Stern School's Professor Paul R. Brown. "It's La La Land."

While the tidal wave of special charges is providing cover for earnings games, it could also be an impetus for change, especially in the wake of the dot-com fiasco. Indeed, there are some signs of a backlash. The real estate investment trust industry was a pioneer of engineered earnings, with its "fun from operations," or FFO. But now some REITs have begun to revert to plain old GAAP earnings. Hamid R. Moghadam, C

Cover Story



performance, says Baruch Lev, a professor of accounting at the Stern School of Business at New York University. "Are these really one-time events?" he asks. "Or is this the beginning of an avalanche?" Indeed, Morgan Stanley Dean Witter & Co. strategist Steve Galbraith has found that in the year following a big charge-off to earnings companies have underperformed the stock market by 20 percentage points.

"LA LA LAND." Investors are apt to be faced with more huge write-offs next year, even if the economy doesn't continue to worsen. Why? The transition to a new GAAP rule that changes the way companies account for goodwill—a balance-sheet asset that reflects the amount paid for an acquisition over the net value of the tangible assets. Under the new rule, companies will have to assess their properties periodically and decrease their worth on the balance sheet if their value falls. An informal survey by Financial Executives International of its

formation on cash expenses and how they bear on earnings. An easy step would be to require companies to file the press releases with the SEC.

At the least, says Lev, companies must clearly explain how their pro forma numbers relate to the GAAP numbers. Otherwise, he says, investors "see numbers floating there, and where did they come from?" In today's environment of unregulated pro forma calculations and supersize write-offs, the question is more important to investors.

With Mike McNamee in Washington

THE SOLUTION

Needed: A set of rules for calculating operating earnings and a requirement to make clear how they relate to net income

of San Francisco-based AMB Property Corp., shifted back to GAAP in 1999. "The reason I don't like FFO is very simple," says Moghadam. "One company's numbers look better than another one's even if they had identical fundamental results."

There are other steps FASB could take to improve financial reporting and restore GAAP's status. Trevor Harris, an accounting expert at Morgan Stanley, says it could force companies to make clear distinctions between income from operations and income from financial transactions. Lehman's Willens says companies should provide more in-

BusinessWeek online

For an interview with SEC chief Harvey Pitt, go to the Nov. 26 issue online at www.businessweek.com.

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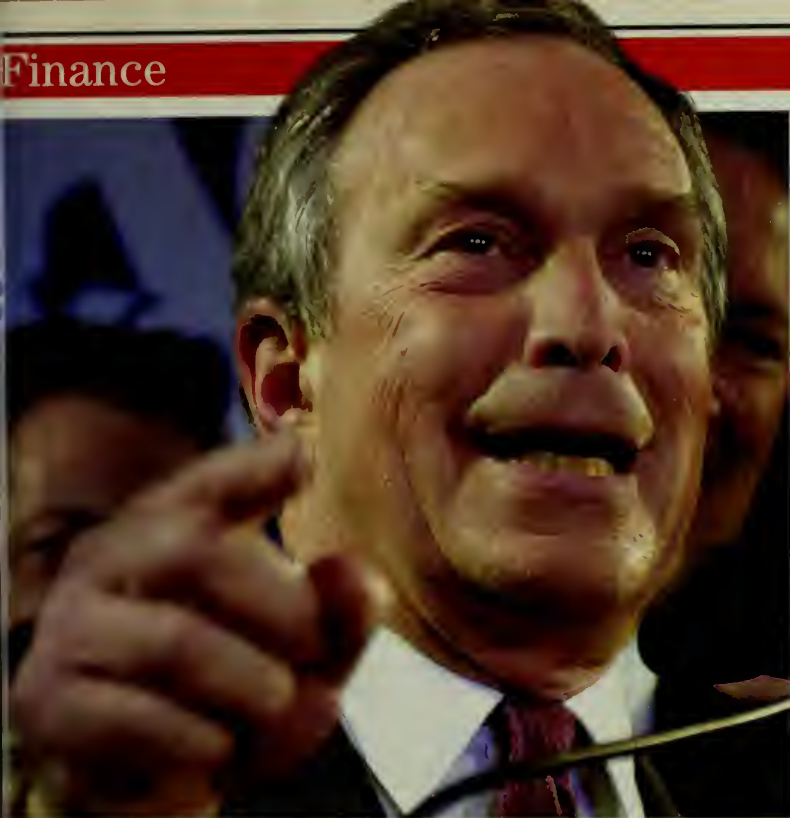
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A CONFLICTED MAYOR MIKE?

New York's Conflicts of Interest Board will soon rule on the Mayor-elect's complex business relationships

- Bloomberg owns 72% of his company, whose biggest customers are Wall Street firms that vie to be New York City's bond underwriters, chosen jointly by the Mayor and the City Comptroller.
- Merrill Lynch, Bloomberg LP's only outside investor, holds a 20% stake. It also makes millions in bond underwriting for the city and won \$27.6 million in city tax abatements in 1997.
- Bloomberg's board of directors includes executives with strong ties to Wall Street, including board Chairman Peter T. Grauer, a managing director at Credit Suisse First Boston, and former SEC head Arthur Levitt.
- Bloomberg leases seven terminals to the city, accounting for about \$108,000 a year in business.

Data: BusinessWeek

EDIA

WHAT'LL BLOOMBERG DO WITH BLOOMBERG?

It's not a great time for New York's mayor-elect to bow out

As Michael R. Bloomberg entered a midtown hotel elevator on the night of his victory in the New York mayoral race, former Governor Hugh L. Carey pulled him aside and recounted a bit of history for the 51-year-old billionaire. Back in 1880, the city elected as mayor William Russell Grace, a shipping magnate with no political experience. Grace would spend mornings in City Hall, Carey told the mayor-elect, and afternoons down the street tending to his business, W.R. Grace & Co. Bloomberg, who remains one of the privately held company he founded 20 years ago, laughed at Carey's story, then vowed that, as the city's 108th mayor, he wouldn't pursue dual careers.

Still, extracting himself from Bloomberg LP, in which he holds a 72% stake, would become Bloomberg's first messy

challenge even before he's sworn in on Jan. 1. Speculation is already rife that he is considering selling his company, perhaps for an asking price of more than \$10 billion. A Bloomberg spokeswoman denies the company is for sale, but either way, Bloomberg's departure could mean turmoil for the \$2.5 billion-a-year financial-data-and-media empire.

Bloomberg will be leaving his company to an executive team that has been around for years, but no one member possesses the outsized personality that has helped make the Bloomberg name and terminals ubiquitous on Wall Street. Bloomberg also leaves amid the worst economic downturn in a decade. Analysts are predicting that the company's sales growth of 15% in 2000 will be cut in half next year. And rival Reuters PLC is gaining market share and charges lower prices for its financial data.

Bloomberg's departure "has got to hurt," says John A. McConville, editor of quarterly guide *Market Data Industry*. "You're removing an egotistical and charismatic leader. Whatever he brought to the table is now gone."

Bloomberg as mayor is raising ethical issues as well, since he owns a company whose biggest customers are the investment houses that bid regularly to underwrite city bonds. Merrill Lynch & Co., his only outside partner, with a 20% stake, is a senior underwriter of city bonds and in 1997 received \$27.6 million in tax abatements for promising to keep 9,000 jobs in New York City. Merrill officials declined comment. (Bloomberg has said he won't seek tax abatements for a new 700,000-sq.-ft. headquarters to be completed in 2004.) Bloomberg aide Bill Cunningham sees no conflict with selecting underwriters: "Ultimately there is no conflict [because] they all lease Bloombergs," he says. But the mayor-elect will have "to be extremely careful not to show favoritism," warns Columbia University finance professor David O. Beim, a business ethics specialist.

NO BLIND TRUST. Bloomberg has said he will abide by the decision of the city's Conflicts of Interest Board, which in the coming weeks is expected to review his holdings. The decision will be made by board members Jane W. Parver, a partner at law firm Kaye Scholer LLP, and Bruce Green, a Fordham University law

professor. A third board member, Benito Romano, is likely to recuse himself since his law firm, Willkie Farr & Gallagher, has worked for Bloomberg LP and defended him and the company against three sexual-harassment lawsuits by former employees. Parver, Green, and Romano declined to comment.

Many politicians with business interests opt to put their investments in blind trusts while in office, but because Bloomberg's stake is so large and not in public stock, a blind trust wouldn't solve the problem. The conflicts board could let Bloomberg keep his stake but place tight restrictions on how and when, as mayor, he deals with Wall Street firms that are also Bloomberg customers. But such constraints would undermine his main appeal to voters: his business savvy that has become so critical to the city's post-September 11 economy.

"A BIT RICH." The conflicts board could also go to extremes and require him to sell outright. Company insiders value the privately held empire at north of \$10 billion, or roughly four times revenues. In addition to the Bloomberg wire service, there are magazines, radio and TV operations. About 95% of annual revenues, however, come from leases on 160,000 terminals. The "Bloombergs," as they have come to be known, provide traders, brokers, and financial analysts with reams of information, from breaking news reports to complex analytics. "This is still a great asset, but that price is a bit rich," says one media investment banker. "Their margins won't stay where they are."

So who would be interested? Thomson, Dow Jones, Reuters, Pearson, and The McGraw-Hill Companies, the parent of *BusinessWeek*, are some of the names in circulation. A Dow Jones spokesman says his company has no interest. Spokespersons for the other companies declined to comment. If it's not an all-cash deal, Bloomberg could still find himself in a predicament—by holding stock of another company with ties to the city.

The job of guiding Bloomberg into its third decade will most likely fall to Lex Fenwick, the company's former head of U.S. and European sales who was appointed chief operating officer in June. When Bloomberg resigns as chief executive, Fenwick will probably be elevated. But as the company prepares to yank Mike Bloomberg's signature from the first screen of its terminals, where it has been displayed for years, don't expect Fenwick's to fill that space. After all, the company is still called Bloomberg.

By Tom Lowry in New York

INVESTMENT BANKS

NO DEAL TOO SMALL

M&A bigwigs go after the midsize market

It was the kind of deal that Wall Street bankers might have snubbed a year ago. Private equity firm Questor Management Co. wanted to sell bankrupt bicycle maker Schwinn/GT Corp. Not one, not two, but five marquee investment banks, including Lehman Brothers and Credit Suisse First Boston, lined up to compete for the deal. CSFB won and sold the company to Pacific Cycle LLC and Direct Focus Inc. for \$151 million in late September. "The good thing about the current merger-and-acquisition environment is that smaller transactions receive the attention of top-tier advisers," says Garrett P. Kanehann, a vice-president at Questor.

The fight for the Schwinn deal is yet another sign of hard times on Wall Street. Bankers who once boasted of handling \$60 billion megadeals are being forced to lower their sights to M&A transactions worth \$500 million or less as business dries up. This year, only 13 deals have been worth more than \$10 billion, down from 43 in 2000. Megadeals still being done, such as Hewlett-Packard Co.'s troubled

\$23.5 billion purchase of Compaq Computer Corp., are tough to pull off. Or they're time-consuming, unsolicited bids, such as Echostar Communications Corp.'s \$31.5 billion bid for Hughes Electronics Corp. Hostile takeovers now make up 11% of the total, up nearly four times from 3% in 2000, according to Goldman Sachs & Co. estimates.

MIGRATING. Overstaffed Wall Street houses are clutching at smaller deals as a way of staying busy. "Times like this, everybody trades down to keep their people employed," says John Herrmann, a managing director of M&A at J.P. Morgan Chase & Co. True, the value of announced U.S. deals worth less than \$500 million is down 45%, to \$100 billion this year. But the middle market has held up much better than deals over \$1 billion whose value has plunged 58%, to \$50 billion, says Thomson Financial Securities Data Corp. "Finding an investment banker to represent us was not difficult," says Bill Naumann, president and CEO of Hatteras Yachts Inc., which Bear Stearns is selling to Brunswick Corp. for \$100 million. "The middle market is where deals are getting done and investment bankers are migrating to where the action is."

It's where the rewards are, too. The solid fees earned by midsize deals are holding up well, adding to their appeal. "Although there has been considerable downward pressure on fees in large transactions, fees on smaller deals have continued to hold steady or rise," says J.P. Morgan Chase's Herrmann. Indeed, while the average fee for a deal over \$1 billion



SCHWINN

Five top-tier investment firms competed to advise on the Schwinn sale



Hatteras

"Finding an investment banker to represent us was not difficult," says Hatteras CEO Bill Naumann

many are struggling as institutional investors such as pension funds shift away from taking positions in smaller companies; the funds only want to hold stakes they can sell quickly if the need arises. Some small fry are also being pushed into a growing throng of so-called orphans, companies for which investment banks no longer issue analysts' research although they took them public. "Sellers have gotten more realistic," says Don Meltzer, global head of M&A at CSFB, whose team specializing in mid-sized deals advised 135 transactions under \$1 billion this year. "They're not saying it will get better in six months. If they wait for an increase in value, they realize they may have to wait six years."

That's not to say that small and midsize companies are easy to sell. These days it's tough to find buyers with enough cash even for smaller deals. Many are forced to use I.O.U.s because they can't raise all of the money they need. "We're finding a lot of frustration on the part of our clients who want to buy, but can't," says Dennis Soter, head of the corporate finance department of consulting firm Stern Stewart & Co.

Buyers are also wary of cheap merchandise. Most have had enough of trying to rescue companies with busted business models. "Many of the companies that want to sell right now are doing so out of need rather than desire because of the downturn in the economy," says Evan W. Siddall, an M&A managing director at Goldman Sachs who specializes in selling smaller companies.

Still, advising smaller companies is better than having no work at all. For now, Wall Street's heavy hitters are committed to help these clients strike the best price for strategic sales and acquisitions. How long they'll stay around when the stock market recovers and megadeals are back in style is another question.

By Emily Thornton
in New York

on is now 0.48%, down from 0.56% in 2000, fees for deals under \$500 million have actually risen to 2.31% from 1.62% in 2000, according to Thomson Financial. And bankers are managing to keep their minimum fees in the \$1.5 million to \$2 million range, no matter how small the transaction.

At the peak of the bull market, overretched larger firms left most of the smaller assignments to a patchwork of investment banking boutiques and the corporate finance arms of consulting and accounting firms. Now, the smaller firms are fighting back by picking up off-bankers from big firms or entering partnerships. Already, a subsidiary of Silicon Valley Incshares has bought investment banking boutique Alliant Partners for \$100 million, and Japanese securities firm Nomura Holdings Inc. picked up a 3.75% stake in San Francisco-based investment bank Thomas Weisel Partners LLC for \$75 million on Oct. 31. "(A strategic alliance) something we're always open to," says Jack W. Hyland Jr., a partner at McFarland Dewey & Co., a firm that handles deals valued between \$30 million and \$100 million.

MALLER BETS. Boutiques and investment banks expect to enjoy brisk business in middle-size deals for at least the next 12 months, thanks to the legions

of cash-strapped corporations, private equity groups, and entrepreneurs. Banks are more willing to make smaller loans for middle-size transactions than provide big money for megadeals. CEOs are also loath to take on too much risk. "The deals are smaller because chief executives are willing to take smaller bets rather than bigger bets right now," says Sean McDevitt, managing director at investment banking boutique Alterity Partners LLC.

Smaller companies also are no longer holding off in the hope of seeing a stock market rebound any time soon. Indeed,

BOTTOM FISHING

Announced deals

SELLER	BUYER	PRICE (MILLIONS)	ADVISERS
CLARIFY (NORTEL)	Amdocs	\$200	CSFB/Morgan Stanley
MISSISSIPPI VALLEY GAS	Atmos Energy	195	Goldman Sachs/Merrill Lynch
PRODUCT HEALTH	Cytoc Corp	167	JP Morgan Chase/Morgan Stanley, Robertson Stephens
SCHWINN/GT*	Pacific Cycle/Direct Focus	151	CSFB/Piper Jaffray
HATTERAS YACHTS	Brunswick Corp.	100	Bear Stearns/Merrill Lynch

*Completed

Data: Thomson Financial Securities Data Corp., companies

STOCKS

PROFITEER OR PERSECUTED ENTREPRENEUR?

Edward Heil is fighting to keep eSafetyworld listed on Nasdaq

Its corporate headquarters is a few cramped, messy rooms in a Long Island (N.Y.) office park, and its product line consists of helmets, goggles, and other safety gear. ESafetyworld was as humdrum as a company can be—until Oct. 19, when it announced that it had developed a “revolutionary product” that would make it possible to safely open anthrax-laced mail. By day’s end, eSafetyworld shares had soared fivefold on huge volume. But trading was swiftly halted by Nasdaq, which sought further information on the company’s claims. On Nov. 12, eSafetyworld said it was fighting expulsion from Nasdaq. Says CEO Edward A. Heil:

“I’m sorry we invented the damn thing.” **WIDELY HELD.** Is eSafetyworld an unscrupulous profiteer from the anthrax scare—or a victim of regulatory paranoia? That’s one of the questions facing investors as they strive to make sense of the trading frenzy over stocks of companies seeking to profit from the post-September 11 public-safety concerns. Regulators warn that overly enthusiastic—or even outright false—corporate pronouncements may be unfairly exploiting the crisis, sometimes with dire results for investors. In the case of eSafetyworld, which says its claims for its product are valid, potential investor losses are considerable. Almost 6.6 million shares—more than twice its 3 million shares outstanding—traded on Oct. 19 and 1.9 million on Oct. 22, the next trading day, at prices four to five times the recent average. None of the



shares can be sold until the company satisfies Nasdaq’s information request. Heil says it has done that. But after three weeks, trading remains halted.

Investors in eSafetyworld aren’t the only ones in limbo. On Nov. 7, the Securities & Exchange Commission temporarily halted trading in 2DoTrade Inc., which claimed to be developing an anthrax disinfectant.

And Vital Living Products, whose stock skyrocketed on publicity over its anthrax test, saw its share price collapse when one of its early statements proved incorrect. Vital stands by its product, and 2DoTrade says it is cooperating with the SEC.

ESafetyworld’s Heil insists his \$800 MailSafe Containment

Chamber will win over the sternest skeptics, including Nasdaq. At the center of the fuss is a glass box just under a yard wide, resembling a fishtank with rubber gloves protruding into it. The unit is sealed with gaskets, and Heil insists it is airtight when latched shut. The company demonstrated it for *BusinessWeek* in a conference room it shares with other companies in a Bohemian (N.Y.) building. Air pressure in the box is reduced when the lid is shut, but the demonstration did not reveal whether the chamber was totally airtight. The company says it tests all units for air-tightness before shipping and that it has received 30 orders, of which half have been shipped.

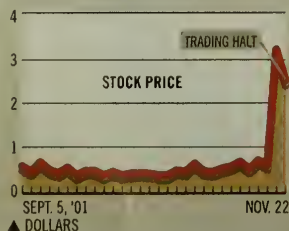
AWAITING RESULTS. ESafetyworld has demonstrated the product for Nasdaq, too. Nasdaq said in a statement that it had asked the company for more information and that trading would remain halted “until eSafetyworld has fully satisfied Nasdaq’s request for additional information.” So has eSafetyworld passed the test? Nasdaq did not return a call seeking comment, and eSafetyworld attorney Neil Kaufman said “we wouldn’t think so” when asked if the product failed the Nasdaq demonstration. He declined further on-the-record comment, saying that was at the best of Nasdaq.

Kaufman and Heil expect to defeat the delisting effort, which was a Nasdaq “staff determination” that eSafetyworld is appealing. In a Nov. 12 press release, eSafetyworld said Nasdaq was concerned about the company’s failure to make a timely filing of its annual report and expressed “concern about the content of and procedures relating to its recent press releases, its reported financial results, including revenues, and other matters.”

If “content” is an issue, it could be serious stuff. Still, the company is hanging tough. “I hope you won’t lump us in with that company that was suspended by the SEC,” said Kaufman. In eSafetyworld’s view, regulators are being hasty and unfair. But by acting swiftly when confronted with questionable claims, Nasdaq has sent a stern warning to companies that might be tempted to give their stock an unwarranted lift by dashing off a press release: Capitalize on post-September 11 misery at your peril.

By Gary Weiss in Bohemia, N.Y.

ESAFETYWORLD'S WILD RIDE



Data: Bloomberg Financial Markets



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GOLF

A FRANTIC SEARCH FOR THE NEXT TIGER

Is golfer Ty Tryon, a pro at 17, being rushed by sponsors?

Ty Tryon insists that he's just a normal teen who likes hanging out with his friends and devouring fast-food hamburgers. Yet no 17-year-old in America had an October like Ty's.

First, Callaway Golf Co. signed Tryon to an endorsement contract. The next day, Target Corp. hired the Orlando high school junior to model a new "youthful" sportswear line that the discounter will be selling next spring. All told, Tryon's endorsement deals, with incentives, could hit \$1 million this year.

That's a reflection of the promise and pizzazz that this golf prodigy has displayed in a few forays on the PGA Tour this year. It also speaks volumes about the feverish pursuit of sports marketing's next big thing. "Everyone is searching for the next Tiger Woods, that breakout guy who might emulate what Tiger has done," says sports marketer Jeff Bliss, president of Javelin Group in Alexandria, Va.

Tryon has 50 tournaments to win before he can share bragging rights with Tiger. But for someone who can't legally order a pint of beer, he has made impressive strides. Last March, while just 16, Tryon became the youngest player since 1957 to survive a 36-hole cut on the PGA Tour. Four months later, at the B.C. Open, Tryon briefly had the lead after a blistering, first-round 65. "Ty is certainly a phenom and someone who will be getting a significant amount of attention the next few years," predicts Andy Pierce, a senior vice-president at IMG, the sports-marketing giant that represents both Tryon and Tiger.

"COMPETITIVE FIRE." In August, Tryon—who has his own Web site (tytryon.com) and sports car (Lexus IS 300)—announced his most audacious move: turning pro. Even Woods opted for two years on Stanford University's golf team before joining the pro ranks.

For Target, though, Ty's tender age may be the whole point. As part of his three-year deal with the Minneapolis-based retailer, Tryon will help develop a line of shirts and slacks aimed at young shoppers. Will other teens want to be like Ty? "I haven't thought about it,"

says Tryon. "Maybe they'll see me [on tour] and think, 'That's cool.'"

Callaway expects that Tryon's appeal will extend far beyond the MTV set. "We think as many 60-year-olds will be talking about Ty Tryon as 15-year-olds," says Callaway Senior Vice-President Mike Galeski. In signing Tryon, Callaway continues to lock up players

"LOW-LITES" FROM TY'S WEB SITE

► My dog, Petrie, got run over in the driveway when I was 7.

► Had sinus surgery when I was 9.

► Made a 10 on the last hole of the Optimist International Junior Tournament when I was 11.

► Cited for noise pollution in a mall parking lot at 17.

► On the day it's announced that I'm turning pro, I shot an 80 at [the 2001 U.S. Amateur]. With some good breaks, it could have been a 70. If I hadn't tried my best, it could have been a 90. Golf is an amazing game.

Data: www.tytryon.com

with the potential to challenge Woods. Callaway spokesman Charles Howell III, 22, is finishing a brilliant rookie season with \$1.5 million in tourney winnings. "We have a couple of young guys here who have that competitive fire to go out and beat Tiger Woods," says Callaway CEO Ron Drapeau.

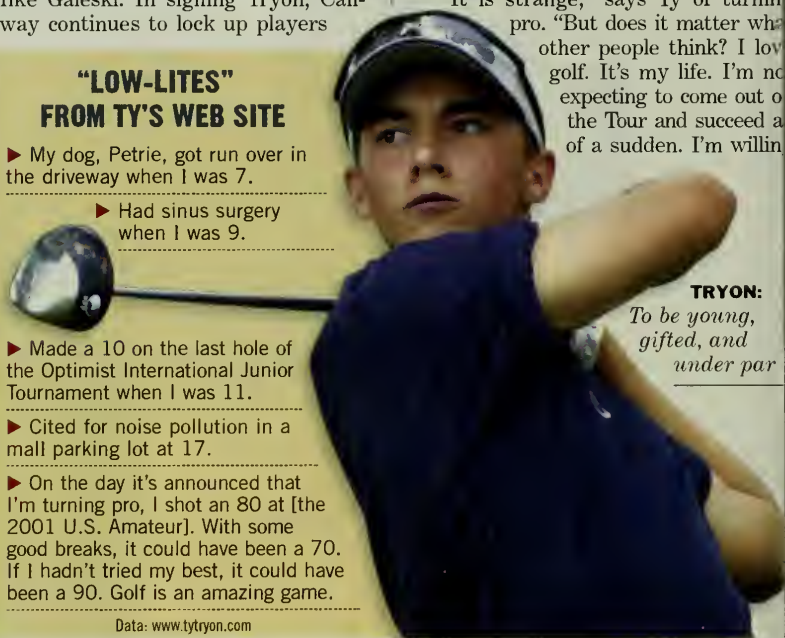
Callaway's excitement about Tryon turning pro doesn't seem to be shared by the PGA Tour, which views his early exit from the amateur ranks with alarm. In September, it enacted the so-called Tryon Rule, which bars players under 18 from membership in the Tour. That won't stop Tryon from playing the Tour under sponsor exemptions, of which there will be plenty, given his reputation and IMG's clout. And by June, when he turns 18, Ty will have finished Tour

qualifying school and could be a carry carrying PGA pro.

Even if that happens, his agent says Ty hopes to play the Tour only on a part-time basis until he graduates. But some PGA veterans still question whether turning pro before the junior prom is even the right call. "The pressure, the week-long grind—it's not a good environment," says veteran golfer John Cook, whose son played on the same high school golf team as Tryon last year. "[Ty is] a great kid with a phenomenal attitude. But I don't know of a teenager who could handle it." Cook says he has offered much the same assessment to Ty and his dad, Bill Tryon, a mortgage banker, and that he and the Tryons agreed to disagree.

"I understand people think it's strange,

It is strange," says Ty of turning pro. "But does it matter what other people think? I love golf. It's my life. I'm not expecting to come out of the Tour and succeed all of a sudden. I'm willing



TRYON:
*To be young,
gifted, and
under par*

to fail. The next couple of years are more of an apprenticeship."

Still, the influence of endorsement riches on Ty's decision to make the leap is hard to ignore. Tryon concedes that the prospect of such deals "did encourage me. I'm not going to lie about that. But Target and Callaway executives insist they studiously remained hands-off until Tryon and his parents had finalized their plans. "We weren't at the front pushing Ty to come play pro golf," notes Drapeau, who points out that before the deal was signed, company officials wanted assurances from Tryon and his parents that Ty intends to finish high school.

Tryon gave his word. He might even attend graduation—if the U.S. Open isn't on the same day.

By Mark Hyman



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DYNERGY'S WATSON

He says Enron's core business is strong. But others worry that more accounting tricks will turn u

don't think anybody foresaw the problems [at Enron]," he says. "It's been incredible to watch."

Watson, 51, has to make good on what may well be his riskiest investment yet. If he can pull it off, the new Dynergy will have revenues of more than \$20 billion and \$90 billion in assets, including more than 22,000 megawatts of power-generating capacity and 25,000 miles of pipeline. It would control an estimated 20% to 25% of the energy-trading market, up from about 6% now.

That would be sweet vindication for Watson's strategy. Dynergy backs trading operations with hard assets such as power plants, which allows the company to guarantee a supply of electricity to a buyer. In contrast, Enron has worked furiously to shed power plants and oil and gas-generating fields, believing it could earn higher returns using its trading and technology expertise to tap assets owned by others in markets including steel, pulp, and paper.

IRRESISTIBLE BARGAIN. As Enron's stock slid below \$9 from its August, 2000, high of \$90, it became a bargain that Watson couldn't pass up. It would have taken years for Dynergy to build up a market-making operation to match Enron's. Its risk-management systems are top-of-the-line. Enron's commercial-services unit, which manages power supplies for corporate customers such as Wendy's International Inc., is three or four years ahead of Dynergy's, says Steve Bergstrom, president of Dynergy. Watson says he still plans to get rid of the \$1 billion worth of assets Lay had earmarked for sale, including the Portland (Ore.) General Electric plant and oil and gas assets in India. For the \$1.5 billion, though, if the deal falls through Dynergy

will have the right to Enron's prized Northern Natural Gas pipeline worth an estimated \$2.25 billion. And Dynergy can walk away with Enron's legal liabilities exceeding \$3.5 billion.

Watson firmly believes that Enron suffered from a crisis of confidence, not a meltdown of its core business. Indeed, Enron's wholesale-trading operation

ACQUISITIONS

ALL EYES ON THE ENRON PRIZE

If the deal holds, Dynergy will walk away with some juicy assets

As Houston-based Enron Corp. imploded amid a dizzying scandal over its finances, few would have blamed Dynergy Inc. CEO Charles L. Watson if he had sat back and gloated. After all, Watson had watched as his bigger, brasher crosstown rival sniffed at Dynergy's more cautious strategy, all the while garnering most of the credit for reshaping the energy-trading business.

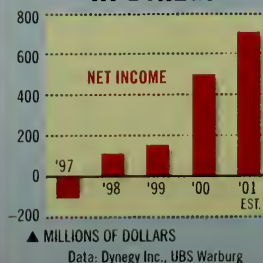
Instead, Watson picked up the phone on Oct. 24 and called Enron Chairman, CEO, and longtime acquaintance Kenneth L. Lay to ask how he could help. Lay didn't respond immediately, but as Enron's stock continued to plunge and the company faced a cash squeeze, it became clear what the only realistic answer could be: Bail us out.

So two days later, Lay invited Watson to his River Oaks home near downtown Houston for breakfast to discuss a deal. Over muffins and "a bad cup of coffee" the next day, Watson recalls, they

sketched the outlines, and by 10 p.m. that night, the investment bankers were called in. On Nov. 9, Dynergy announced that it would pay about \$10 billion, plus the assumption of \$13 billion in debt, to buy Enron, which is nearly four times its size. The key to the deal was Dynergy's immediate \$1.5 billion infusion of cash to shore up Enron's balance sheet and save its credit rating. The money came from Dynergy's 26% owner, ChevronTexaco Corp.

Without that help, Enron—the seventh-largest U.S. company, based on its \$100 billion in sales last year—may well have faced bankruptcy. Watson says that he never would have imagined such an outcome in his wildest dreams. "I

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ation earned \$2.3 billion last year. Says Watson: "We know the business. We looked under the hood, and guess what? It's just as strong as we thought it was."

But the trading profits were obscured in recent weeks by Enron's accounting tricks. The biggest danger for Watson is that there are other time bombs ticking away. Already, the company has slashed its reported earnings since 1997 by \$591 million, or 20% of its total, to account for controversial partnerships involving Enron officials. The Securities & Exchange Commission is still investigating. "We believe it will take more than just a couple of weeks and a long-term relationship [between Watson and Lay] to do all the necessary due diligence," says analyst Carol Coale of Prudential Securities Inc. Dynegy's Bergstrom counters: "We're pretty certain that most everything of material consideration has been disclosed." If not? The massive earnings boost provides "a high margin of error," he says.

A WANNABE. Of course, regulators may object to the concentration of trading operations. And Watson will have to mesh two very different cultures. Enron is known for its intense, even cut-throat entrepreneurial spirit. Dynegy's operations are more conservative; some compare it to a fraternity. Dynegy's decision to issue new stock options to some Enron employees may soothe battered egos. It should help, too, that Lay decided not to take the \$60 million golden parachute he could have received in a buyout. As it is, Lay will not have a management job with the new company.

Dynegy often seemed to be an Enron wannabe, following it into online trading and commercial services. Still, Dynegy's 361% stock gains last year eclipsed Enron's 87% rise, and it rankled some that Lay's execs got more credit. "Chuck Watson may not have been in the spotlight, but he has always been at the forefront of this business," says Bruce M. Withers, who sold his Trident NGL Inc. to Dynegy in 1995. Watson will get more attention next year—he's a 15% owner of the new Houston Texans pro football team. But with his bold takeover of Enron, Watson has ensured that he's off the sidelines for good.

By Stephanie Anderson Forest, with Wendy Zellner in Dallas, and Peter Coy and Emily Thornton in New York

THE OTHER INSTANT POWERHOUSE IN ENERGY TRADING

It's not easy being No. 4. Despite a \$35 billion merger completed in October, ChevronTexaco Corp. is still not one of the oil superpowers. Nor, at more than \$90 billion a year in revenues, is it a scrappy little guy. So Chairman David J. O'Reilly has been searching for a strategy beyond just drilling for more oil and gas.

Now, he may have something: a big stake in the No. 1 energy-trading company. Chevron Corp. has owned 26% of Dynegy Inc. since 1996, and with Dynegy's planned acquisition of Enron Corp., the top energy trader, ChevronTexaco is making the oil industry's most aggressive push yet into this fast-growing business. It plans to eventually pump \$2.5 billion into the combined Dynegy and Enron to maintain its 26% stake, and it might raise that share. So, while ChevronTexaco's much bigger rivals run small in-house trading operations, energy

trading may soon account for more than 10% of ChevronTexaco's earnings. "Chevron is now positioned to be a leader in the business," says analyst Arjun Murti at Goldman, Sachs & Co.

The deal would certainly dovetail with ChevronTexaco's strategy of becoming a more integrated energy company, with a hand in everything from pumping oil at the wellhead to trading natural-gas futures. By acquiring Texaco, Chevron picked up, for instance,

a big refining-and-marketing business—which should balance out the bad times in oil and gas production, says Eugene Nowak, an analyst at ABN Amro. "When crude-oil prices are down, they'll have margin improvements on refining and marketing," he says. O'Reilly and other ChevronTexaco executives declined to comment.

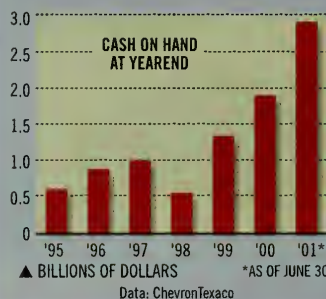
Until now, Dynegy wasn't a big deal for Chevron. Chevron purchased the stake for \$700 million when Dynegy was still called NGC Corp., and it filled three of the 14 board seats—positions it will keep. Since then,

Chevron has sold nearly all its domestic natural-gas production to Dynegy. The stake has been a good investment: it is now worth \$3 billion, ChevronTexaco says.

Sitting on \$2.9 billion in cash as of the end of the second quarter, ChevronTexaco can well afford the Dynegy deal, analysts say. And they expect O'Reilly to use some of that to make more buys; the most likely target is a natural-gas company. Maybe it's not so bad being No. 4.

By Louise Lee in San Mateo, Calif.

CHEVRON'S GROWING CASH HOARD



A PIECE OF THE ACTION

Its 26% stake in Dynegy gives Chevron three seats on the new board



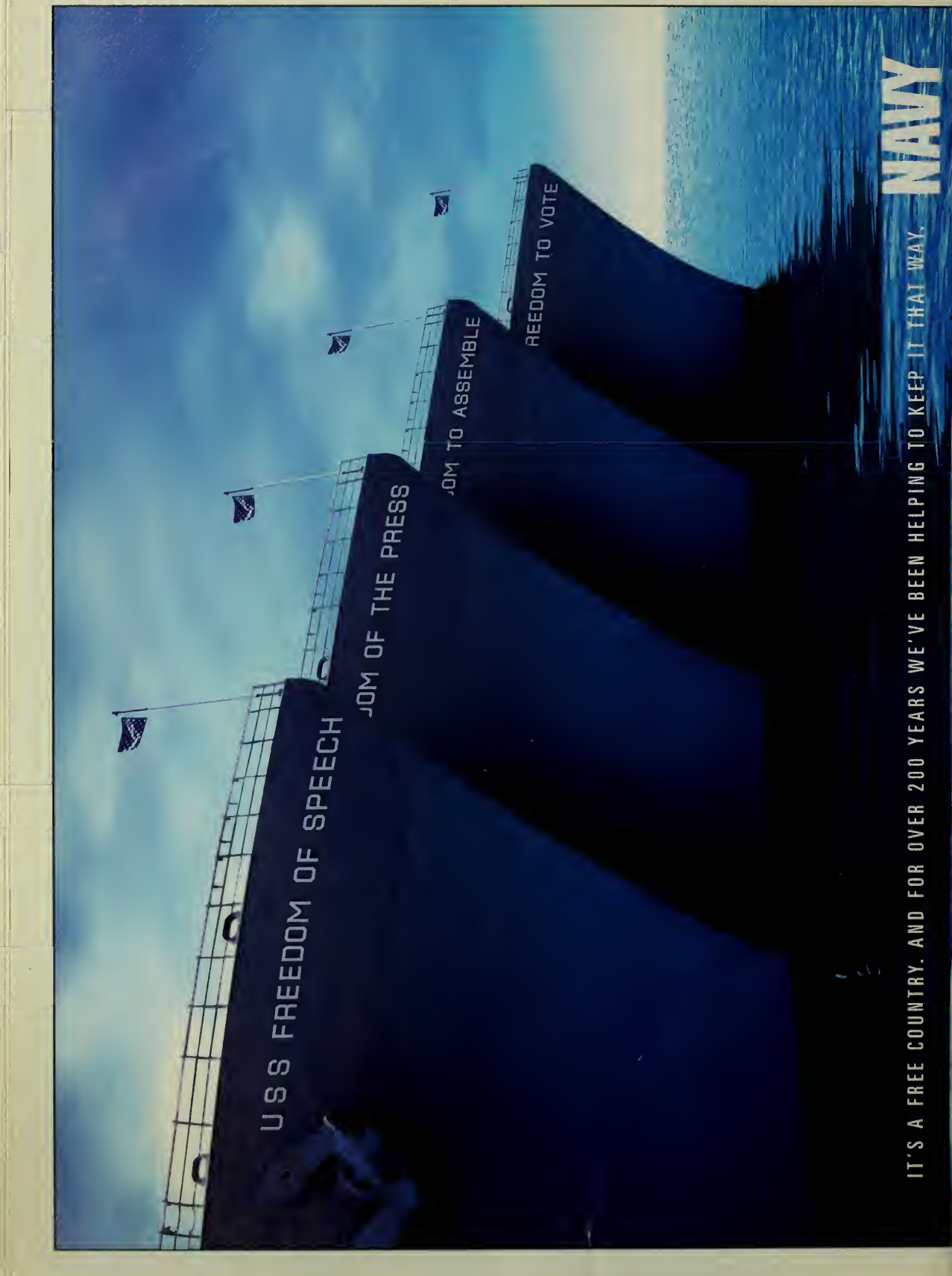
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AT HONEYWELL, IT'S LARRY THE KNIFE

With the failed GE deal and an aerospace tailspin, Bossidy's plan seems to be "cut, cut, cut"

Shortly after returning to Honeywell International Inc. in July as chairman and chief executive, Lawrence A. Bossidy was taking questions from workers at a town-hall-style meeting at the company's Morristown (N.J.) headquarters when an employee asked him a seemingly innocuous question: Would Honeywell still have its annual picnic? Without missing a beat, the hard-nosed CEO shot back: "Hey, you've been on a picnic since I left."

The message was clear. The 66-year-old Bossidy is determined to revitalize the diversified manufacturing concern with the same intensity and drive that has marked his career through a series of senior jobs at General Electric Co.; at AlliedSignal, where he ran the show; and at Honeywell itself, where he was chairman for a scant four months after Honeywell and AlliedSignal combined. Now, back from retirement to lead Honeywell after its long-planned merger with GE fell apart, Bossidy must get a thoroughly demoralized company on its feet again. He also has to restore its depleted management ranks, convince Wall Street that the company can be a moneymaker, and recruit a seasoned and respected successor—all before next summer, when he again plans to retire.

Bossidy has little choice but to move aggressively. "He came into a broken company with broken businesses," says Roger R. Threlfall, senior manag-

ing analyst at Honeywell investor Dreyfus Corp. "This company has been at a standstill, and he needs to get it moving again." By the end of this year, Bossidy's tough restructuring plan calls for Honeywell to have taken \$2.2 billion in charges, largely to cover the cost of slashing 15,800 jobs—13% of its workforce—and shuttering 51 manufacturing facilities. In Honeywell's crucial aerospace business alone, it will lose 5,300 employees, reducing its ranks by 14%, to 32,000. Bossidy also plans to unload underperforming businesses with \$2.5 billion in sales, including a brake-pad unit and a pharma-

ceutical chemicals operation. "His strategy is to cut, cut, cut," says Steven Roda, senior equity analyst at American Express Financial Advisors Inc., a Honeywell shareholder. "And he's very good at that."

UP IN THE AIR. Like many executive Bossidy's job was complicated by the September 11 terrorist attacks. Honeywell's sophisticated aviation-systems and components businesses account for about 40% of sales and 60% of operating profit. Now its prime customers, which include Boeing Co. and many major airlines, are hurting.

Certainly, Honeywell will grasp some opportunities by helping airlines upgrade security and by seeking more military aerospace-related business. No commercial business currently accounts for about a third

aerospace sales. Honeywell is a big subcontractor on Lockheed Martin Corp.'s new Joint Strike Fighter, for example. The contract is expected to generate \$5 billion in revenue over the next 20 years. Honeywell will provide components, including the plane's wheels, brake and onboard oxygen system. But that won't be enough to o-

BOSSIDY'S ACTION PLAN

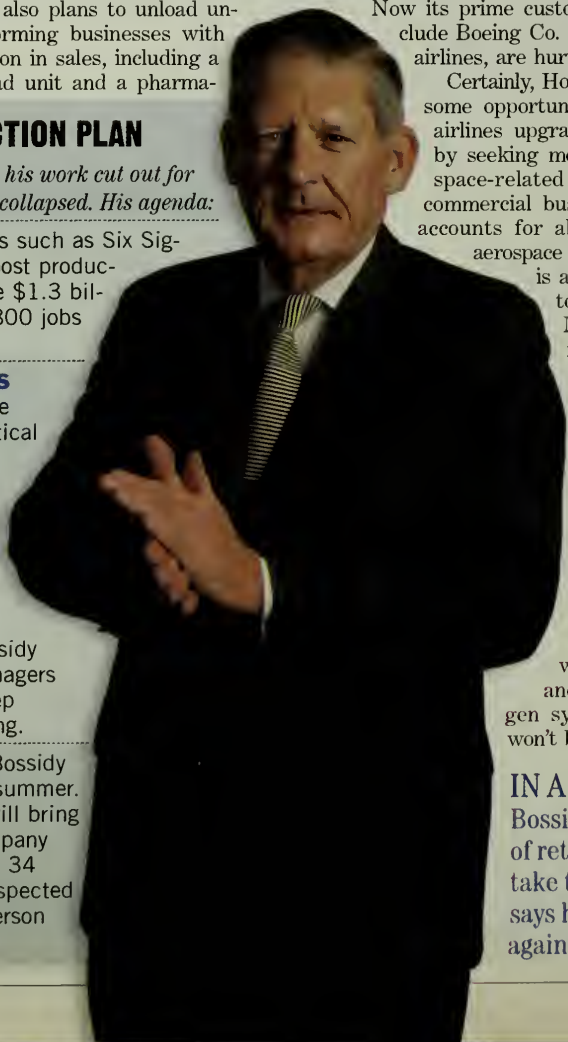
Honeywell's CEO has had his work cut out for him since the GE merger collapsed. His agenda:

CUT COSTS Using tools such as Six Sigma, Bossidy plans to boost productivity, which should save \$1.3 billion next year. And 15,800 jobs are being cut.

UNLOAD STRAGGLERS Units up for sale include brake pads, pharmaceutical chemicals, and others totaling \$2.5 billion in revenues.

REBUILD MANAGEMENT Many execs fled after the '99 AlliedSignal merger and the failed GE deal. But Bossidy has lured some top managers back and lobbied to keep dozens more from leaving.

FIND A SUCCESSOR Bossidy says he will retire next summer. The betting is that he will bring in a veteran from a company like GE, where he spent 34 years, UTC, or a well-respected competitor such as Emerson Electric.



IN A HURRY Bossidy came out of retirement to take this job—and says he'll retire again next July



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set the falloff in commercial aerospace demand and weakness in other industrial businesses, which are being hurt by the downturn. In fact, Deutsche Banc Alex. Brown Inc.'s Harriet C. Baldwin figures Honeywell's sales will slip 6% this year, to \$23.6 billion, from \$25 billion, while aftertax operating income, which excludes restructuring charges, will tumble 27%, to \$1.7 billion, from \$2.3 billion.

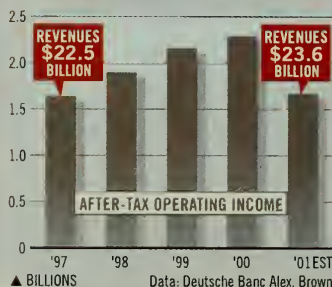
So Bossidy is also pushing hard for productivity improvements. He is a longtime proponent of Six Sigma, the process for eliminating manufacturing defects that was made famous at GE. That tool helped generate 31 consecutive quarters of double-digit earnings growth for him at AlliedSignal.

Bossidy is hustling to get more Honeywell operations online. For example, Honeywell's heating, ventilation, and air conditioning systems unit will soon start using handheld devices rather than handwritten invoices to transmit maintenance and repair requests to its 1,500 field technicians. That's expected to save \$4 million annually. Bossidy says total productivity improvements and cost cutting will save Honeywell \$1.3 billion next year—enough to offset the slowdown in aerospace and other businesses.

DISTRACTION FACTOR? Honeywell shares, recently \$31.70, have fallen 9.7% since Bossidy's return on July 3, while the Dow Jones aerospace index has declined 15.9%. Not everyone, however, buys into Bossidy's program. Prudential Securities Inc. analyst Nicholas P. Heymann says he is skeptical about the savings targets. For one thing, the company itself admits to only \$550 million in savings this year, far less than it had wanted. And Heymann believes that big productivity increases next year could fall victim to slack demand and soft prices. Some investors also worry that Honeywell's cuts will be so deep that it won't be able to develop and deliver new products when the economy recovers. Bossidy, of course, says that future growth won't be compromised. He adds that this year's relatively scant savings resulted from the distraction of Honeywell's aborted takeover by GE, when the company was more focused on integration planning than executing its cost-cutting strategies.



HONEYWELL HITS A ROUGH PATCH



At the same time that Bossidy is cutting costs, he is also trying to stabilize Honeywell's management ranks. The company saw significant defections during the merger with AlliedSignal in 1999. The new company, with old Honeywell CEO Michael R. Bonsignore (who declined to talk with *BusinessWeek*) at the helm, was largely staffed with AlliedSignal managers. But after years under the focused and hard-charging Bossidy, some of them say that they felt adrift with the more laid-back Bonsignore. Bossidy personally conducted detailed quarterly reviews with business unit managers; Bonsignore would leave that job to two senior execs. The culture clash led to numerous executive departures. And the exodus continued after GE made its bid for the company in 2000. Bossidy acknowledges that with people unsure about whether they would have a job, they were operating "with one foot out the door."

The fallout from such management uncertainty is still being felt in parts of the company. In a key piece of the automation and control business, for example, Honeywell has lost share to

competitor Emerson Electric Co., which in 1998 came out with a cheaper system to monitor and control various manufacturing processes. "We were able to run out and es-

tablish a lead," says John M.

Berra, execu-

SAVING GRACE? Honeywell has a Joint Strike Fighter role

tive vice-president at Emerson. Bossidy has since tapped a Honeywell veteran to overhaul the automation and controls business. Eight of the top 13 managers in the operation are now new to Honeywell or transfers from other units. Companywide, Bossidy has lured back several former executives and successfully lobbied to keep some 50 others from leaving. Despite those efforts, the company concedes that gaps in middle management still exist.

SHOES TO FILL. Bossidy himself returned only to help Honeywell out of its current crisis. Who will succeed him? Robert P. Luciano, former chairman of Schering-Plough Corp. and a Honeywell director, says Bossidy discussed several internal and external candidates for the job at a September board meeting. He adds that Bossidy is already meeting with potential successors. While Honeywell is tight-lipped about the search, one industry source figures Bossidy may try to lure an executive from Emerson Electric, United Technologies, or GE, where Bossidy spent 34 years before moving to AlliedSignal.

Of course, Bossidy could just end all his headaches by selling Honeywell. Its avionics business had been a lure to GE and also enticed UTC to make a run at the company. But with the aerospace industry in a tailspin, that seems unlikely—at least for now. Besides, Bossidy is adamant that the company won't be sold on his watch. "You can write this out of the playbook for some time," says George David, CEO at UTC, speaking of any prospective Honeywell sale. "We're talking years." That's why Bossidy must convince Wall Street that Honeywell has a plan that will allow it not only to survive, but to prosper, too.

By Amy Barrett in Philadelphia, with Diane Brady in Hartford, Conn.

In the uncertainty following GE's bid, many employees were operating 'with one foot out the door'

WHY DIDN'T I KNOW ANYONE IN THE ELEVATOR?

WHAT BUSINESS ARE WE IN, ANYWAY?

IF WE OUTSOURCED MORE THINGS, WE COULD BE MORE FOCUSED. I'M ALL ABOUT FOCUS.

I WONDER HOW THE PRODUCTION ON MY CABIN CRUISE IS GOING. I WANT A STATION THAT PLAYS MORE TALK, LESS ROCK.

WHY DIDN'T THE LAST GUY DECIDE TO OUTSOURCE?

IT'S ALMOST NOON AND NO ONE HAS SAID HAPPY BIRTHDAY. WE'VE COME A LONG WAY IN 18 MONTHS. I NEED A NEW PHOTO FOR THE ANNUAL REPORT.

I STILL CAN'T BELIEVE I WAS NOMINATED FOR CEO OF THE YEAR. I HOPE I DON'T SIT NEXT TO MY WIFE AT THE PARTY AGAIN.

I SHOULD HAVE BEEN A SOMMELIER.

FORGOT TO CALL MOM AGAIN. HOW ABOUT THIS FOR A DEPARTMENT SLOGAN: I.T. IS "IT" THAT'S CLEVER.

ARE WE DONE YET? I'M GOING SPELUNKING. WHAT DID THIS COMPANY EVER DO BEFORE THE T. DEPARTMENT?

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ON BEHALF OF EVERYONE IN I.T., I'D LIKE TO KISS THE PERSON WHO SUGGESTED OUTSOURCING OUR HR STUFF.

BIKE RACKS IN THE LOBBY - WHY ARE WE NOT TALKING ABOUT THAT?

3 MORE MINUTES, AND THE LILMEL SERIES ON THAT INTERNET AUCTION IS MINE.

I WISH TO KISS THE CORNER OF THAT SPIDER.

I SHOULD HAVE BEEN A WARLORD. MAN, THESE SHOES ARE COMFY.

TIME TO NOD AND LOOK PENSIVE.

SHOULD I RENEW MY SEASON TICKETS?

IF THERE'S NO SMOKING IN THE BUILDING, HOW COME IT REEKS OF CIGARS?

COULD I KEEP STEVE FROM LEAVING AS WELL?

THOSE GARDENING AWARDS WERE TOTALLY RIGGED. IS FLAG DAY A BUSINESS HOLIDAY?

MMMM. FRESH COFFEE. MAYBE THE INTERNS CAN GET US SOME LUNCH.

HOW WILL SOMEONE FIGURE THIS OUT? WE CAN'T FIGURE THIS OUT?

WILL TAKE A VACATION THIS YEAR. I WILL TAKE A VACATION THIS YEAR.

IT'S BEEN A WHILE SINCE ANYONE HAS COME OUT A NEW CANDY BAR. I WON'T TAKE A VACATION.

I'VE NEVER OUTSOURCED BEFORE. BUT THEN, I'D NEVER KARAOKEED BEFORE AND NOW, I ROCK.

I NEED TO TALK WITH GRE ABOUT HIS FUTURE HERE. MAYBE TOMORROW.

I HOPE THESE PEOPLE ARE AROUND WHEN IT'S TIME TO IMPLEMENT THINGS.

I WAS THE ONE WHO SUGGESTED OUTSOURCING, NOT TED. WHY DON'T PEOPLE REMEMBER THAT?

I FORGOT TO TELL THE DRY CLEANERS "LIGHT STARCH."

IT'S BEEN A MAJOR ETC.

I DON'T WANT TO KNOW WHAT THAT ART IS.

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TIDYING UP AT HOME DEPOT

Bob Nardelli is bringing GE's discipline to a retail giant

These are a few things that Robert L. Nardelli has learned in his first year as chief executive of The Home Depot Inc.: to shout the company cheer and wear an orange apron whenever he visits a store; to say "sku" as shorthand for stock-keeping unit, not "S.K.U."; and to expect a kiss on the head when he greets co-founder and chairman Bernard Marcus. Hey, Nardelli used to be a football player. He understands camaraderie.

Executives at Home Depot have always encouraged that kind of exuberance. The company culture might best be described as rowdy. The idea was to grow big, fast. It did: Since 1979, Home Depot has gone from four stores in Atlanta to 1,301 in four countries. During the 1990s, profits at the nation's top home-improvement retailer grew an average of 35% a year. So what if the company got a little sloppy? It could

afford to. Few managers, it's safe to say, spent much time thinking about metrics or best practices.

But efficiency is what the 53-year-old Nardelli is all about. Nardelli, who in December gave up a 27-year career at General Electric Co. after he lost the race to replace CEO Jack Welch, knows a thing or two about making businesses run better. "He's got the GE discipline, and he brought it to us. And we needed it," concedes Marcus. As the economy slides into recession and rival Lowe's Cos. moves into the big urban markets Home Depot has dominated, improving operations is now imperative. "There's more change ahead for the company over the next two to three years than there's been over the past 10," says J.P. Morgan Chase & Co. retail analyst Danielle Fox.

Home Depot certainly had its share of problems in 2000. Its profits grew just 11%, after increasing by more than 40% the year before. Sales in stores open a year or more increased only 4%, compared with 10% in 1999. Now, Nardelli's cost-cutting is kicking in: Profits grew 20% for the third quarter and should rise 16%, to \$3 billion, for the year, according to Budd Bugatch, retail analyst at Raymond James & Associates. He expects 2001 same-store sales to flat and overall revenues to grow 14%, to \$52.3 billion. The company's stock price has slid to about \$44, from a high of \$68.75 on the last day of 1999.

REDUNDANCIES. The economy can't get so much blame for the troubles at Home Depot. Executives were so focused on opening stores—total square footage increased an average of 25% a year during the past decade—that they didn't pay enough attention to controlling the company's sprawling operations.

In contrast to other big-box retailers, such as

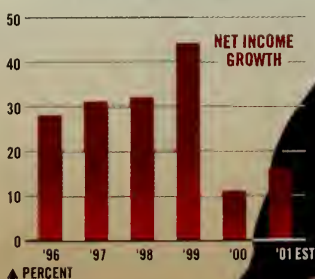
FIXER-UPPER

Nardelli's first move was to trim new-store openings—a sensitive issue at a company hooked on growth

A HUGE DROP IN SALES GROWTH...



...HAS PROFITS GROWING SLOWER...



...AND PUSHES DOWN HOME DEPOT'S STOCK



Data: Home Depot Inc., Raymond James & Associates, Bloomberg Financial Markets

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"We're not letting the economy take us off strategy," says Nardelli. "We want to be a \$100 billion business"

as Wal-Mart Stores Inc., Home Depot's basic systems—purchasing, accounting, and logistics—had not been updated in years. Buyers from the company's nine regions each dealt directly with suppliers, which created redundancies in the company's \$37 billion supply chain. Inventory controls were loose, too many layers of managers impaired accountability, and there was no uniform system to assess employee performance. As a result, return on investment, while an impressive 19.6%, hasn't improved since 1991. Analysts say it should have, as Home Depot leveraged its growing store base.

Enter Mr. Fix-it. His first decision was to cut 9% of the new stores planned for this year; Home Depot will open 204, the same number as last year. "We're not letting the economy take us off strategy," he says. "We want to be a \$100 billion business."

ROLE REVERSAL. If Home Depot does get there under Nardelli, it will be because of the nuts and bolts. Nardelli moved quickly to flatten levels of management, make regional managers more accountable, and centralize purchasing in Atlanta. He told every store to get with the new service program before the end of the year: Employees now restock at night instead of driving forklifts through the aisles while shoppers are around. It takes away that warehouse feel, but it's safer, and employees no longer spend just 30% of their time with customers and 70% restocking. Now it's the reverse. He expects the change to generate the equivalent of 70 stores' worth of sales, or some \$2.8 billion. Nardelli also tightened the customer return policy: A receipt is now required for all cash returns. And for the first time in the company's history, stores stayed open on Easter Sunday. Nardelli, a Catholic, even took his family to one that day.

Marcus and his partner, Arthur M. Blank, were so eager to hire Nardelli that they agreed to give him Blank's job as chief executive instead of just the post of president. Imagine the shock of most employees: They knew nothing about Nardelli, and he knew little about retail. Blank left the board in May; Mar-

cus will step down as chairman in December and serve as a director until next May. For now, Nardelli and Marcus talk by phone at least once a week.

Joining what was essentially a family-run business with a distinct, almost *laissez-faire* culture was not easy. And some certainly see Nardelli as an interloper who doesn't get what Home Depot is all about. "Everything he's doing is



ROBERT LOUIS NARDELLI

BORN May 17, 1948, Old Forge, Pa.

EDUCATION BS, business, Western Illinois University, 1971; MBA, University of Louisville, 1975.

CURRENT POSITION President and CEO, Home Depot.

PREVIOUS JOB CEO, GE Power Systems.

ON THE MOVE Uprooted his family 11 times during his career.

LESSON FROM WELCH "Jack taught me a lot about trusting your gut."

AFTER HOURS Throws great parties, which often include Elvis impersonators.

FAMILY Married to Sue, his college sweetheart. They have three sons and a daughter, ages 15 to 26.

counter-culture," says a former senior vice-president who left a few years ago. "It's bad for morale." Some midlevel managers have left, as well as one top executive, Mark R. Baker, head of merchandising and once considered Blank's likely successor. And Nardelli's No. 2 is a colleague from GE, Dennis M. Donovan, who heads human resources. Nardelli admits there was "a lot of anxiety and trepidation about the transition" but says he's trying to "protect the holy grail of culture."

It's easy to see where Nardelli got his intense focus on keeping track of the money. From his parents, children of

the Depression, he learned that "you need to earn your way in life." His father started out as an hourly employee at GE and rose to plant manager; his mother took care of the two kids. While attending Western Illinois University on a football scholarship in the late 1960s, Nardelli took a summer job paving highways. He can come off as extremely serious, but everyone has their frivolous side: Nardelli is known for his lavish Hollywood-themed parties, replete with Elvis impersonators. **SHORT-LISTED.** Retailers rarely turn to total outsiders, but that's definitely what Nardelli was a year ago. "I came here a kind of dry sponge," he says, almost proudly. He figured that he could apply 75% of the skills he honed at GE—where he started in 1971, straight out of college. Over the three decades that followed, he headed the Canadian appliance unit, the transportation systems division, and GE Power Systems, where he took over in 1995. At the time, the business mostly sold power-generation products. Nardelli transformed it into one of GE's most profitable divisions, developing the services it offered; made about 90 deals and quadrupled revenues, to \$20 billion. He also managed to win over the locals in Schenectady. Early on, he and the mayor teamed over the need for an environmental cleanup at the company's campus. Nardelli worked to find a solution, though, and earned the mayor's respect.

On paper, Nardelli's performance was the best of any manager. He followed the GE formula with great precision: "Never show him a number you don't want to deliver, because he will remember," says Donovan. But some believe that for all that, Nardelli wasn't the strategic thinker Welch was looking for.

At Home Depot, Nardelli's GE-style directness has jolted some employees. But he is trying to make sure he has good feel for the staff. He's held town hall meetings and met with associates deemed to be on the fast track. He likes to give out pay increases on the spot, as well as candid assessments of an employee's prospects. Marcus and Blank motivated people with hugs and cheer. Nardelli knows some of that is necessary, but he prefers metrics and a simple measure of fear. Wonder who he learned that from?

By Aixa M. Pascual in Atlanta

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MYTH: Bigfoot in the woods.



FACT: Linux in the enterprise.

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MYTH: Linux® isn't ready for the enterprise.

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Example: Korean Airlines consolidated flight scheduling systems and daily revenue tracking from a variety of different platforms onto Linux servers. Supporting service to 77 cities in 29 countries, more than 3,000 Korean Air pilots, flight attendants and other employees use the systems daily.

Example: Telia, Scandinavia's largest telecommunications and Internet service provider, recently replaced 70 UNIX® servers with one IBM mainframe enabled to run 1,500 copies of Linux simultaneously.

Example: Grede Foundries is a \$600 million supplier of industrial castings. Grede moved DNS, mail and Web serving, network monitoring applications and online manuals to Linux on their mainframe, gaining performance and reliability and cutting costs.

MYTH: Linux lacks business applications.

FACT: Over 2,500 Linux applications are listed in the IBM Global Solutions Directory at ibm.com. Included are over 1,300 e-business applications.

Key developers have embraced Linux and more are doing so all the time. Including names like SAP, SAS®, jBASE, QAD and Sanchez.TM They realize that Linux is a key to flexible infrastructure. IBM itself is the world's leading middleware company, and all our key middleware is Linux-ready.

MYTH: Linux lacks service and support.

FACT: At IBM and IBM Global Services (the world's largest technology services and consulting company), we're backing Linux with the same level of service we offer on any other operating system. Same as UNIX. Same as Windows®. Same as IBM's operating systems.

IBM has hundreds of professionals dedicated to Linux, ready to design, build and support enterprise-level e-business infrastructures. And we aren't alone. Linux distributors and service organizations (like Linuxcare, Caldera®, Red Hat, SuSE and Turbolinux®) and the vast, global Linux programmer community combine to offer strong support for the platform.

MYTH: Linux isn't secure.

FACT: Linux is just as secure as other operating systems. You don't have to take our word for it. Take the word of the world's foremost security organization, the National Security Agency. The NSA is investing resources to develop and promote high-security mechanisms in Linux. They chose Linux because of its growing success and open development environment.

MYTH: Linux doesn't really save money.

FACT: The fact that Linux is free (or is available for a nominal fee) is a very small part of the overall cost-efficiency of Linux. Through workload consolidation and the wide availability of Linux-skilled programmers, Linux solutions can cut all kinds of costs.

The Weather Channel's Web site, weather.com, is the world's leading source of online weather information. During weather crises, traffic soars to 40+ million page views in just days. weather.com needed a cost-effective platform on which to quickly add capacity and handle wildly fluctuating traffic. They chose Linux running on IBM xSeries Intel-based servers for their Web, application and database needs. The Linux platform resulted in a 70% cost savings over other platform options, as well as lower incremental growth costs.

BOTTOM LINE: The facts are clear: Linux is here and Linux is ready. Ready for business. Ready for e-business. Ready for the enterprise. For more facts or help with Linux, call us at 1 800 426-7777, Priority Code 101DY021, or go to ibm.com/linux/cio2



DOWNSIZING

IS BOEING CUTTING TOO CLOSE TO THE BONE?

Huge layoffs could leave it shorthanded when orders rebound

Just a week after the September 11 attacks, Boeing Co. responded with some grim news of its own. The Chicago-based aerospace giant said it would cut 30,000 jobs from its commercial aircraft division in Seattle and slash jet deliveries by nearly 50% over the next two years. The company was responding to a

ON THE LINE: Already, the Renton plant is turning out 737s with just

two assembly lines instead of three
But Condit wasn't laying out the whole story. For months prior to September 11, top company and union officials say privately, Boeing had been quietly drawing up plans to slice employment in its commercial-aircraft business by 10,000 to 15,000 jobs over several years, or some 15%. The factors pushing the decision included slower sales, sliding market share, and management's efforts to lift productivity and hand work off to subcontractors. The idea was to rely on efficiency gains to assemble jets faster with fewer people. Thus, the announced cutbacks extended beyond what Boeing needed to meet the sudden crisis of oversupply posed after the terrorist attacks, the officials say.

NO SURE THING. Is the world's largest plane maker moving too fast? A recent study suggests that the steep layoffs could leave Boeing woefully short of skilled workers if orders rebound substantially over the next few years. The hoped-for efficiency gains depend on avoiding a repeat of the crippling production snarls that occurred when the company imposed a slew of new manufacturing techniques back in 1997. But that's by no means a sure thing. In addition, the planned cuts antagonize already strained relations with the company's two biggest unions, which accuse Boeing management of sacrificing people for

profit. "We expected an adjustment coming before September 11," says International Association of Machinists & Aerospace Workers (IAM) President R. Thomas Buffenbarger, who represents 62,000 Boeing workers. "But they are using it as an opportunity to justify an overreaction in the magnitude of the lay-



offs." A Boeing spokesperson insists that all 30,000 layoffs are related to the slump in demand following the September 11 terrorist attacks.

No question, Boeing had to scale back sharply after the disaster. The precipitous drop in air travel has prompted airlines to delay scores of plane orders. Management responded immediately with production cuts. Boeing is on track to deliver 522 planes in 2001, but the September 11 tragedy will shrink that to 400 next year and under 300 in 2003.

Even so, big cuts had already been in the works, the company insiders say. Those had been planned as part of the

drive that began earlier this year as an effort to leapfrog the higher productivity of European rival Airbus Industrie. The push involved the same kind of leaner assembly-line system that triggered the 1997 production fiasco. But this time, management appears to have worked out some of the kinks. For example, it has started to shift the industry's first-ever moving assembly line for the final phase of the production process, which cuts out the needed steps. That contrasts with the traditional stationary assembly. Already the Renton (Wash.) plant turns out 737s with just two assembly lines instead of three, eliminating the need for hundreds of workers.

Now, Boeing hopes to apply this approach to other operations where it

HOW BOEING PLANS TO SHRINK

The giant aircraft maker has announced a drastic downsizing following the airline industry's post-September 11 slump. But many of the cuts were already in the works. Here's what Boeing is likely to do:

- ▶ Slash 30% of commercial airplane unit, or 30,000 employees
- ▶ Shutter up to four factories in Washington state that build component parts for commercial aircraft and some defense products
- ▶ Possibly close a 4,500-worker plant in Long Beach, Calif.
- ▶ May consolidate an 8,000-employee factory in Renton, Wash., with a larger one in Everett, Wash.
- ▶ Lift outsourcing to more than 60% of components, up from 49%

Data: BusinessWeek

ished planes are put together, including assembly lines for 757s in Renton as well as those for 747s, 767s, and 777s at its Everett (Wash.) plant. If it works, the company could speed production by 50% or more and maintain its double-digit profit margins on commercial plane sales. "There's a lot of additional capacity that could be taken out of the system" using leaner manufacturing techniques, says analyst Peter Jacobson of Ragen MacKenzie, a unit of Wells Fargo in Seattle.

The question now is whether Boeing can pull off such an ambitious agenda in the midst of a massive and painful

ownsizing. The company has already squeezed out many of its younger workers in the past few years, particularly engineers. It did so as a result of efficiency gains, but also because plane orders declined from their 2000 peak of 108. The current layoff plan would slash Boeing's total workforce by nearly a third, to about 60,000, leaving an order backlog and few skilled replacements-in-training. At the same time, Condit expects orders to rebound by 2003, lifting production rates back up to pre-September 11 levels in the following years.

MORE LEVERAGE. If that happens, Boeing will need all of its productivity plans to pan out as expected or it may be caught short ramping back up to 500 planes a year. Indeed, a recent study by Massachusetts Institute of Technology found that the aerospace industry is already cut 500,000 positions since 1990 and hasn't done enough to replace its aging workforce. "We're facing a critical-skills shortage" down the road, says Robert E. Scott, an economist at the Economic Policy Institute in Washington and a co-author of the study.

It didn't take long for the company's 70 major unions to vow to resist the sale of the announced downsizing. Union proposals to dampen the impact with early-retirement packages, voluntary layoffs, or less outsourcing to contractors have so far gone nowhere, say both the IAM's Buffenbarger and Charles Bofferdg, executive director of the Society of Professional Engineering Employees in Aerospace (SPEEA). That could undercut morale and stir worker resentment, union leaders warn. SPEEA's 25,000 Boeing engineers and technical workers have become more militant in recent years, mounting their first strike ever against Boeing in 2000.

The IAM has even taken the company to court. The union charges that Boeing outsourced jobs to subcontractors in violation of its 1998 labor pact. "We're seeing a couple thousand jobs lost due to this violation," says IAM District 751 president Mark A. Blondin, whose unit represents 24,000 production workers. Boeing spokesperson says all the job shifts to suppliers comply with the union's contract. Still, the IAM's pact expires next year, which will give members more leverage to battle outsourcing and layoffs.

CEO Condit has been struggling for years to lift Boeing's efficiency and bring down labor costs. If all goes according to plan, he may finally realize his goal when the current cuts go rough. But the price may be steep if there aren't enough workers on hand when the industry revives.

By Stanley Holmes in Seattle

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using sherry casks.)*

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sherry casks and filled them
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years later, we matured and
so did the whisky. We combined
it with whisky from our
traditional oak casks and the
result was awesome — a
smooth marriage of sherry
sweetness and rich oakiness
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The Cyber Traveler

As the B2B marketplace expands and improves, the opportunities for companies to control their corporate travel expenses increase exponentially. A real-time, interactive marketplace allows for unusual purchasing power on everything from first class airline tickets to five-star hotels. And companies whose employees book their own travel arrangements help save significantly on the bottom line—not just on the ticket cost itself, but on various intermediary and administrative costs.

Meanwhile, recent advances in wireless communications turn handheld devices into gateways—for essential travel information, alerts and to reservations engines for last-minute schedule tuning. And the explosion in broadband has completely transformed the way meetings, training sessions and presentations are held.

This special section focuses on the dynamic new tools companies can use to save time and money and at the same time, boost employee productivity and morale.

The Meeting of the Future

A host of new-style conference facilities and telecommunications tools are totally transforming the way meetings are run, information is shared and collaboration is fostered. “The days of conference rooms with tablecloths draped over folding tables and a pad and a pen at every seat is passe,” said Brad Barrett, president for Connect Center, Inc., a suburban Atlanta-area based firm that’s developing ways to provide shared spaces. Meeting rooms at more forward-looking hotels are

already wired for presentations, discussions and audience participation—no more power cords duct-taped to the carpet. And as companies have become more cost-conscious, and as people become much more comfortable with virtual communications, Web conferencing use is markedly rising. Even before the events of September 11, the use of visual conferencing applications was skyrocketing.

According to Mark Levitt, research director for collaborative computing

at the International Data Corporation, companies spent \$175 million last year on online meeting services. This number is expected to more than double to nearly \$400 million in 2002.

What exactly is a virtual meeting? Imagine a cross between a video conference and a training session. Participants log onto a Web site, log in a password, and take part in some sort of meeting, demonstration, announcement or tutorial. The fee is based either on the number of participants or conference length.

Toshiba, for example, uses a custom-branded **WebEx** Meeting Center service to host “Virtual Training Classrooms” for its internal training programs. WebEx’s communications infrastructure supports interactive data, voice and video communications, allowing Toshiba trainers to hold interactive Web meetings through a standard browser.

And while most companies are using virtual meetings for training

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The Cyber Traveler

and internal communications, more and more are finding that virtual meetings are highly effective sales tools as well. John Bower, national manager of sales and training at CCH Inc., a provider of information on tax and business law, began using online collaboration tools from **PlaceWare** a year ago to help market the company's tax preparation software to accountants.

Other companies are using virtual meeting services to determine whether a prospective client is serious before dispatching a sales rep to make a sales call. Some firms use Web conferences at weekly sales staff meetings, or to facilitate customer care across multiple borders and multiple time zones. Ronald Auble, technology manager for Eastman Kodak, said that sales-people in Kodak's headquarters in Rochester could go home, have dinner, and at 8:00 or 9:00 p.m. log onto a virtual meeting service and have a confab with Australian or Chinese representatives. "It's definitely helping us shrink our world," Auble said.

Hotel companies, including **Hilton** and **Marriott** offer Web casting capabilities. Marriott's EventCom Technologies division allows companies to link participants around the world by Web casting presentations, either live or prerecorded, to the desktop of any computer. EventCom supports satellite video conferencing; ISDN video conferencing, which allows two-way interaction; Web streaming to distribute documents, and audio conferencing, a productive, low-cost alternative to virtual meetings.

Kinko's (www.kinkos.com) has a cost-effective solution for companies that would rather not make capital investments in purchasing or leasing video conferencing equipment, or need to extend an existing virtual-meeting network without further incremental equipment costs. Kinko's video conferencing suites, available at 150

locations feature easy-to-operate equipment, and voice-activated cameras that track the action. Presenters can broadcast material directly from their laptops or access the Internet during the conference to clarify a point. Automatic document cameras instantly share photographs, presentations, X-rays, transparencies, etc.



carrier to install Boeing's high-speed Internet service on its aircraft. The carrier is working with Boeing engine before it begins equipping Lufthansa's intercontinental fleet with the service, called Connexion.

It will provide passengers high-speed connectivity to in-flight e-mail, the Internet, corporate Intranets, and live TV.

The days of conference rooms with tablecloths draped over folding tables and a pad and a pen at every seat is passe.

Innovations in the World of "E"

Today's e-travel doesn't just mean you can make reservations on the Web. Travel technology developers, working in concert with travel suppliers and aircraft manufacturers, are teaming up to deliver important new applications that vastly improve the travel experience:

Find out essential information before you go to the airport. Several airlines, among them United, Singapore Airlines and Air Canada, offer notification services that deliver real-time information regarding a flight: whether it's been delayed or cancelled, or if there's been a gate change. With United's version, called Proactive Paging, users register once (instead of every time they book a flight) to get an electronic pre-flight update. Different airlines use different delivery methodologies, but most can set up to deliver a message to an e-mail enabled cellular phone, PDA or alphanumeric pager.

Log onto your e-mail system, even at 35,000 feet. Lufthansa has signed an agreement to be the first foreign

Make a reservation...then check into your hotel room using your cell phone. Six Continents™ Hotels and Resorts, parent company of **Inter-Continental Hotels** (www.intercontinental.com) has launched the industry's most comprehensive wireless services for locating hotels and making room reservations. Working with Air2Web Inc., a leading mobile Internet platform provider, and PricewaterhouseCoopers, which is helping to develop the business strategy and manage the integration of the wireless applications into Six Continents Hotels' enterprise infrastructure, Inter-Continental Hotels & Resorts guests can now easily obtain hotel information from wireless devices including the Palm VII, Web-enabled phones and digital text messaging phones. Guests who are members of the Priority Club® frequent guest program can also make reservations on Web-enabled devices with a minimal amount of effort.

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Best
Gifts

BusinessWeek Lifestyle

Topping This Year's Gift List...

The new DVD players are affordable and come loaded with extras

BY LARRY ARMSTRONG

No question, you can get a sweet deal on a DVD player right now. But before you rush out in hot pursuit of one of those \$79 doorbusters at your local discount store, take heed. For a few dollars more, you can buy a fully decked-out model that does more than just play DVDs, and you can ensure that the lucky person who gets it won't need to shell out more for an upgraded machine when it comes time to replace the TV.

In the four years since the first one hit the market, DVD players have become the fastest-growing electronic product ever. Already, one in three American households owns one, and in September, sales of DVD players surpassed those of VCRs for the first time. In the electronics category, they are this year's most-desired holiday gift, topping digital cameras and flat-screen TVs in an October survey by Web auctioneer eBay.

The low price isn't all that's fueling demand. Movie studios are packing their DVDs with hours and hours of extras—movie trailers, “making-of” documentaries, directors' commentaries—that they can't fit on the videocassette versions of the same features (page 116).

If you're new to DVDs, you'll be amazed at the picture, whatever the price you pay and no matter what TV you own. Images are clearer and crisper, without fuzzy edges. The colors are truer, too, particularly the reds, which have a tendency to spread or bleed on video. But don't fall for the sub-\$100 loss leaders offered as come-ons by the mass merchandisers. They're likely to be close-outs, lacking now-standard features such as the ability to play CD-Rs and CD-RWs, the two types of homemade compact discs. Or they may be stripped-down versions without basic connectors you need to best hook them up to a late-model TV or stereo.

If you want the most bang for the buck, plan on spending at least \$150 (or maybe \$20 less if you shop on the Internet). At that price, a good budget buy is the SD1700 from Toshiba, one

of the inventors of the DVD. Because of the more sophisticated video processing on name-brand players, you should be able to see a sharper picture than on the \$99 machines. Moreover, this model will play homemade CDs, including those with MP3 audio files—important for anyone who downloads music from the Net.

PROGRESSIVE SCAN. For about a hundred dollars more, you can get almost all of the bells and whistles available these days. That would be the Toshiba SD4700, at \$250, or comparable models such as Sony's DVP-NS700P, for \$300, or

DVD PLAYERS

Panasonic's DVD-RP56, for around \$230. Their touted advantage is

that they can show movies in the so-called progressive-scan format, a term you'll hear a lot when you go shopping for a DVD player.

Progressive scan is essentially an insurance policy, a way to future-proof your DVD player so it will work with that digital TV you'll probably buy in the next five or six years. (The Federal Communications Commission requires that all TV stations broadcast digital signals by 2006.) A simplified explanation: Ordinary TV splits each frame of a video picture into two 240-line frames that alternate on the screen. Progressive-scan DVD players display all 480 lines at the same time, just like a computer monitor. You

see the difference, but only if you have a digital TV. Look for thin, horizontal lines on the screen—they won't jiggle. Diagonal lines won't have jagged edges either. If you're watching a progressive-scan picture on a big-screen TV, the horizontal-line structure won't be nearly as noticeable.

You also want your DVD player to play CDs. That way you can get rid of your CD player. For that reason alone, you need to check out I



NIFTY: Panasonic's portable player



Here's a smart twist: Sampo has a \$250 DVD player with a slot for the 1½-inch square CompactFlash card used by many MP3 players and digital cameras. Slip it in, and you can listen to your music or view snapshots on TV. Also check out Sony's \$300 Style Cube. It's a pretty basic DVD player, but it's less than half the size of the others. You can park it vertically in a bookshelf or even hang it on the wall. Another way to save space: Buy a portable that can be used on an airplane or in a car and hooked up to a TV at home. Today's hottest seller is Panasonic's \$1,000 DVD-LA95 with a 9-inch screen, the biggest available.

Other tips for your shopping trip: Turn the DVD player around. Look for a series of three jacks, usually colored red, green, and blue. They make up the component video output, which delivers the highest-quality picture—providing your TV has a matching set. If it doesn't now, your next TV most likely will.

If you plan to play the audio through your stereo system, as in a home theater, make sure the DVD player has a digital-audio output. It will look like a single jack, often colored orange and labeled "coaxial," or a

square, black opening for an optical cable. Better yet, get both, in case you can't remember what your stereo receiver has—or for if you ever change systems.

For this year's "everything" machine, go with the Panasonic DMR-E20, for \$1,000. That's about \$800 cheaper than the closest competitor. It plays everything—DVDs, MP3s, CD-Rs, and RWs—and it records, too. No fewer than four DVD recording formats are coming to market, and this has two of them: one for recording discs to share with friends, and one that records on a single disc over and over again so you can have shows to watch later when it's convenient, just like a VCR.

No matter which DVD player you choose, you're bound to be pleased. At these prices, you can easily afford a second if you decide to buy cheap now and upgrade later. By that time, the kids will be more than happy to have this year's model for their own room.

PLAYERS WITH A DIFFERENCE

TOSHIBA
DVD SD4700 \$250

Entry-level progressive-scan model yields sharply better picture when connected to digital TV.
www.toshiba.com/tacp/
800 631-3811

SAMPO
DVE-631CF \$250

DVD player has slot for CompactFlash card to display snapshots on TV screen, play MP3 audio files.
www.sampoamericas.com/
800 558-5976

PIONEER
DV-C503 \$250

Five-disk DVD/CD changer makes this a good bet to replace your CD player.
www.pioneerelectronics.com/
800 421-1404

SONY DVP-F21
Style Cube \$300

Basic player with flair; small size makes it ideal for tight or unusual spaces.

www.sony.com/
800 222-7669

PANASONIC
DMR-E20 \$1,000

Best buy DVD player/recorder replaces your VCR; write-once disks play in most DVD players.
www.panasonic.com/
800 211-7262

players in person. Most are optimized for playing movies, and many skimp on the audio functions. When you go shopping, take a CD along—one you've recorded yourself, if homemade mixes are important to you—and check how it sounds in different models. Listen especially for dropped notes or static when you load the disc or use the "next" button to skip to the beginning of a new track.

KEY FIVE. Take a look at DVD changers, too. Most, such as the Pioneer DV-C503, Sony DVP-NC600/B, or Panasonic DVD-CV51, hold five discs. They're all about \$250—and no, they're not designed to load in five original-cast *Star Trek* movies for your mind-numbing marathon. Sure, you can do it, but they're really aimed at people who like to load up five CDs for an evening's worth of background music. You can get DVD changers that will hold some 300 discs for about \$500 if you're short on shelf space.

The Inside Story On the Latest DVDs

The bonus material separates winners from losers

BY CHRISTOPHER
PALMERI

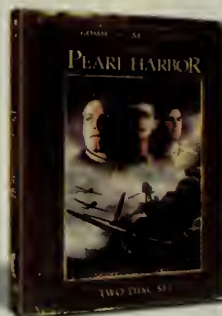
It's easy to see now, 27 years and three Academy Awards later, that *The Godfather* is a cinema classic. But watching the "making of" documentary included in the new *The Godfather* DVD collection shows you just how much of a crapshoot that first picture was. Young director Francis Ford Coppola was lucky to have secured the rights to Mario Puzo's book before it became a best-seller. Paramount Pictures second-guessed Coppola's casting, at one point suggesting that Marlon Brando, who would later win a Best Actor Oscar for his performance as Don Corleone, post a bond in case he got flighty during shooting. The studio, thinking it might need to replace Coppola in midfilm, even had a backup director follow him around.

Such are the juicy extras you get with DVDs. Sure, the picture and sound quality are great. And at around \$20 per disc, the price is right. DVD marketing, though, has

become a war of bonus material. Some is brilliant, a lot is little more than a commercial for the movie. To separate the good stuff from the fluff, I settled onto my couch and explored every last feature in a stack of major yearend releases. Here's what I found:

The Godfather set is a keeper. The five-disc package from Paramount, available for as little as \$74.95, includes early screen tests of Brando, Al Pacino, and Robert DeNiro, who tried out for the Michael Corleone role Pacino made famous. There's also the Best Picture acceptance speech from the first film's producer, Al Ruddy, who bounds onstage in a brown satin tuxedo. Then you have the three films, which Coppola describes as Michael Corleone's journey from reluctant Mob soldier to angst-ridden crime boss. No movie library should be without this collection.

In terms of copies sold, Walt Disney's much-hyped *Snow White and the Seven Dwarfs* will likely be the biggest winner this year. It deserves to be. The two-disc set (list price \$29.99)



includes kids' games, such as a trivia contest called Dopey's Wild Mine Ride. Adults will appreciate Barbra Streisand's rendition of *Someday My Prince Will Come* and a series of documentaries on the history of the Walt Disney Co.

The 60th Anniversary Commemorative Edition of Pearl Harbor (Disney, \$29.99) seems

eerily appropriate in the wake of September 11. In addition to the film, the set includes two documentaries—one from the producers, the other from the History Channel. They reveal just how many scenes in the recent flick came from Pearl Harbor survivors. Viewers also get to see what 700 sticks of dynamite and 3,000 gallons of gasoline in plastic garbage cans look like before they explode. Of note to collectors: In May, Disney will release another version with commentary from director Michael Bay and an additional documentary from National Geographic. It'll cost \$20 more.

For the right combination of technical achievement and good entertainment, *Shrek* (Dreamworks, \$26.99) is the best bet. The two-disc set, when played on a computer, includes a karaoke-like fea-

DVDs

ture that lets you record your own voice and dub it over characters' lines from the movie. Classic-film fans should get

Citizen Kane (Warner Bros., \$29.99). The set includes a documentary on Orson Wells' battle with newspaper mogul William Randolph Hearst that is almost as enjoyable as the movie.

Barbie in the Nutcracker (Artisan, \$19.98) might make a good stocking stuffer. Although the movie is rather slow and humorless, it is visually stunning, a tribute to what computer image generation can do. The disc includes a special feature that lets kids act along with scenes from the movie.

Among the crop of new releases are two to avoid: *Star Wars: Episode I—The Phantom Menace* (Fox, \$29.98) and *Jurassic Park III* (Universal, \$26.98). The fourth *Star Wars* picture is an overwrought snoozer. Watching the bonus features clues you in to just how much money director George Lucas had to burn. Lucas finished scenes he had already cut from the movie—and put them on the disc. *Jurassic Park III* is visually striking, but the disc contains a

lot of discussion about creating the special effects. Too bad the computers couldn't generate a better script.



Raise High The 3D Roof Beam

As she shapes these PC games as they go along

ANNE FIELD

One recent afternoon I walked into our basement, and there was Eleanor, my 10-year-old, sitting at the PC, a look of triumph on her face. On the screen, a roller-coaster car was careening through twists, turns, and dips that could make even the hardiest thrill-seeker queasy. The roller coaster was Eleanor's creation, one she had just designed using a program called *Ultimate Ride*.

It's one of a slew of software games available this season that let kids as young as 8 create or enter entire worlds brought alive by three-dimensional graphics considerably richer and more detailed than in the past. In some cases, such as *Lego Creator: Harry Potter*, you can design all or part of the environment; in others, you shape the creatures within (table). Most of the games are fairly intuitive: A child can figure out the rules without spending a



KIDS' WORLD

GO CREATOR: HARRY POTTER
go Media \$29.99

You'll need to read the manual, but you'll get a real kick to build Potter settings and then cast spells.

AN COMMAND: JURASSIC PARK
owledge Adventure \$39.99

You'll need to read the manual, but you'll get a real kick to build Potter settings and then cast spells.

THE OREGON TRAIL, 5TH EDITION
arning Co. \$24.95

You'll need to read the manual, but you'll get a real kick to build Potter settings and then cast spells.

SNOWBOARD RESORT DESIGNER
ntera Entertainment \$19.99

You'll need to read the manual, but you'll get a real kick to build Potter settings and then cast spells.

ULTIMATE RIDE
ney Imagineering \$39.99

You'll need to read the manual, but you'll get a real kick to build Potter settings and then cast spells.



ZOO TYCOON
Microsoft \$34.95

You'll need to read the manual, but you'll get a real kick to build Potter settings and then cast spells.



for example), the material **HARRY POTTER:** (steel or wood), and track *Players create the scenery*

of making the cars run upside down under the track. When she did a test run, her delight that her creation didn't fall apart could be heard across the street. The payoff, though, was the dizzying ride, which you experience from the vantage point of a rider on the first car. You'd almost swear you're on the real thing.

Eleanor wasn't as enthralled as I was with *Zoo Tycoon*. The graphics don't quite give you the sense, as *Ultimate Ride* did, of being inside a different world. Still, she enjoyed building a zoo from scratch, picking the terrain, and making decisions on everything from which animals to house to how

much staff to hire. When you pick the animals, you get a primer on what type of environment they need. The most entertaining part is keeping the animals happy. If they're not content, a message flashes on the screen. Then you'll have to find out how you've erred. Too much foliage? Not enough food? As you walk through the zoo, you hear startlingly real animal sounds, as well as the buzz of visitors.

GIMMICKY. Eleanor was lukewarm toward *Scan Command: Jurassic Park*, despite the built-in appeal of Steven Spielberg's epic. The game is complicated and leans heavily on what amounts to a gimmick. The software comes with a handheld bar-code reader that you use to scan just about any product in your home, from books to orange juice cartons. The scanner translates numbers in the bar code into dinosaur "DNA" that endows, say, intelligence or strength. You then use the DNA to improve your army of dinos. With this army, you try to wrest control of Jurassic Park from the evil Dr. Irene Cortis and her own coterie of creatures.

While Eleanor had a blast scouring the house for things to scan, the process of converting the DNA into dinosaur attributes is cumbersome. Eleanor liked the fights best. The action seems quite realistic. (No blood, though.) You have to advance through six levels, but neither Eleanor nor I got past the first. Still, it's not every day you can find a gift that looks good, exercises the mind, and entertains you as well as your child.

SOFTWARE

lot of time on the manual. All a kid needs is some familiarity with computers and, in most cases, a PC equipped with at least a 4-megabyte, 3D graphics accelerator card, a feature found in many computers sold in the past year or so. Unfortunately for Mac households, most of the games are just for PCs.

Eye-popping graphics and realistic sound aren't the best part, at least from a parent's point of view. It's how challenging the games are. "They involve a higher order of thinking," testing the player's powers of reasoning and logic, says Warren Buckleitner, editor of *Children's Software & Media Review* in Flemington, N.J. Would this quality also appeal to kids? I turned to Eleanor to see how the games would rate with their intended audience.

Eleanor's hands-down favorite was *Ultimate Ride*. She loved building the roller coaster: choosing the background (inside a nebula,

FENDING OFF THE
TAX MAN, WISE
CHARITABLE
GIVING

BusinessWeek Investor

Turning A Bad Year into Tax Savings

*Even stock losses
can save you money*

BY CAROL MARIE CROPPER

This tax year might be one of those times you just have to take your lemons and make lemonade. Investment losses—or worse, a reduced income due to a layoff or slashed bonus—are bound to leave a bitter taste. And this year's tax cut may wind up seeming like the too-small lollipop you got as a kid after a doctor's shot: Just a half-percentage-point drop in rates is slated for 2001. The cut itself will create problems for some, leaving more taxpayers susceptible to the dreaded Alternative Minimum Tax (AMT).

However, you can squeeze some benefits from your disappointments. And that tax cut will get better in coming years, with rates falling through 2006. Before it's over, the 28% bracket will drop to 25%; the top 39.6% rate will decline to 35%. There are goodies for education as well. One may let you write off thousands in tuition, beginning in 2002, depending on income.

RICH HARVEST. This may be an especially good year to postpone income (maybe asking your boss to give you that bonus—if you still have one—in January) and to accelerate deductions in order to reduce your taxable income. Income, of course, can be hard to move. And in an ailing economy, a payment delayed may be one never received.

One of this year's most obvious ploys to reduce your bottom line is to dump losing investments and use the capital losses to offset gains. Don't have capital gains? You still can write off up to \$3,000 of your losses against ordinary income, carrying the rest forward until it's gone. If you don't think those Inktoni shares, say, are destined to bounce back soon, why not sell by yearend and harvest the loss? Just remember: You must first apply long-term losses against any

long-term gains (typically taxed at the low rate); then, short-term losses against short-term gains (taxed at your regular income-tax rate). After that, you're free to mix and match until gains have been offset, then start applying losses against ordinary income. Harold Shapiro, CPA in Worcester, Mass., says one of his clients is taking \$100,000 in stock losses this year, even though he'll have to carry forward about 70%.

If you sell to claim losses, you can't repurchase the stocks or mutual funds within 30 days. Otherwise, the loss will be disallowed. For mu-

tual funds, a way around this is to substitute a similar fund for the one you're selling.

When dealing with capital gains, you want to avoid triggering the AMT.

The shadow tax system was designed to keep fat cats from using fancy deductions and special tax rates (like the low rate for long-term gains) to escape paying taxes. It kicks in when a taxpayer's tax falls below what it would be if calculated under the more stringent AMT rules. Unfortunately, as stock prices come and stock ownership have risen, more Americans are getting rerouted into this alternate system. The recently passed tax package, with its lower rates, will increase that threat. More and more taxpayers see their burden rising below what they would owe under the AMT, which

Taxes



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we know

they know

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J.D. EDWARDS

The Coming Tax Take

Income-tax rates will continue to drop until 2006 when they hit their low. In 2011, those cuts disappear unless Congress saves them.

OLD RATES	2001	2002-03	2004-05	2006-10
	10.0%*	10.0%	10.0%	10.0%
15.0%	15.0	15.0	15.0	15.0
28.0	27.5	27.0	26.0	25.0
31.0	30.5	30.0	29.0	28.0
36.0	35.5	35.0	34.0	33.0
39.6	39.1	38.6	37.6	35.0

*Applies only to those who did not get rebate

Even if you don't have capital gains, you can still write off up to \$3,000 of capital losses against ordinary income and carry the rest forward till it's used up

the rates haven't changed, warns Don Weigandt, a wealth adviser at J.P. Morgan Private Bank.

Residents of high-tax states such as New York and California are especially vulnerable, since deductions for state taxes are disallowed under the AMT. Investors with lots of long-term capital gains or incentive stock options are also at risk: The AMT doesn't honor the special treatment given them under the regular tax system. David Rhine, a Rochelle Park (N.J.) financial planner, tells of a New York client who profited from the sale of a business this year. Normally, the man would prepay some state tax to increase his deduction and reduce the bite on this year's extra income. But he's afraid that using more of a deduction not honored by the AMT would simply push him into the alternate system.

That old rule—defer income and accelerate deductions—may not apply for those skating near the AMT. It might be better to postpone some deductions if you're near the line. The only way to know for sure is to estimate your regular tax, then run the numbers again using IRS Form 6251 for the AMT.

If you exercised incentive stock options (ISOs) this year, you especially need to check your AMT liability. With ISOs, the difference between the exercise price and the market price on the day you bought the stock is considered a profit under the AMT, even if you didn't sell. That could be a disaster if the stock is now trading much lower. To head off this problem, dump the stock before yearend. That changes the tax treatment of the options, leaving you owing ordinary tax only on any actual profit above your exercise price.

There are other ways to make the best of falling stock prices. If you have a traditional individual retirement account, consider converting to a Roth IRA, where withdrawals are tax-free after you retire. To do this, you first have to pay income taxes on the assets inside the traditional IRA. If your IRA held lots of stocks, it has probably dropped in value, and it'll cost you less in taxes to

make the switch. "If your IRA was worth \$100,000 last year and now it's only worth \$80,000, you pay tax on 20% less money," says Ed Slott, publisher of *Ed Slott's IRA Advisor*. One caveat: File with modified adjusted gross incomes above \$100,000 are ineligible to convert.

A BIGGER PUNCH. For similar reasons, the market fall may be good news for those who want to take advantage of the new 18% capital-gains rate on assets held five years or longer. The clock started ticking on this rate on Jan. 1, 2001, but the rate applies only to assets purchased on or after that date. Those who bought earlier do have a way out. They can take a "deemed sale and repurchase election." Here, you don't actually sell your investment in such things as stocks or real estate. Instead, you pay taxes as though you had, based on the closing price or value at the start of 2001. Five years down the road, those assets qualify for the 18% rate on any gains since. Be warned: This might not be a good strategy if it generates large gains you don't have capital losses to cover. And paying the taxes early will be really galling if the investment later tumbles.

However, prepaying some of next year's state and local taxes and mailing out that January mortgage payment in December are time-honored ways to accelerate deductions. For a bigger punch, goose your charitable deduction by contributing to a donee advised fund. Working through a community trust or an investment firm such as Fidelity or Vanguard, you contribute a chunk of money or securities and get to write off the contribution this year. The money is then doled out over time to charities of your choice.

None of these tricks will make you feel as good as when stocks were booming and employers were wooing you with fat raises and frill-lattes. This year, you'll have to settle for lemonade.

Tax Tips: Making the Best of Bad Times

HARVEST YOUR LOSSES Now might be a good time to dump that losing stock and write off the loss. In general, push income into next year, pull deductions into this one. Remember, your income will be taxed at a lower rate in coming years.

BEWARE THE ALTERNATIVE MINIMUM TAX If you live in a high-tax state or have lots of long-term capital gains, you've just become more vulnerable to this shadow tax system.

CONVERT TO A ROTH With your retirement portfolio down, you'll owe less tax when converting a traditional IRA to a tax-free Roth.

PUT OFF THOSE COLLEGE BILLS TILL NEXT YEAR A short-lived deduction may let you write off \$3,000 in tuition in 2002 and 2003, and \$4,000 in 2004 and 2005.

SET UP A DONOR-ADVISED FUND Need a big deduction? Here's a way to donate a lump sum for charity but have it doled out over time.

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GETTING THE MOST WHEN YOU GIVE



BY ROBERT BARKER

rb@businessweek.com

Just checking how efficiently a charity runs is not enough. A donor also should weigh who needs money most

Tom Cruise was on TV, taking pledges amid the celebrity telethon for the September 11 Fund. That caught Alexandra Leventhal's eye. The president of investment firm Leventhal & Co., which has offices near the World Trade Center rubble, promptly started dialing, hoping "that I would get Tom Cruise on the phone," she said. "But he was busy." She never did give to the fund.

Maybe just as well. It's turning out that Americans gave millions more than needed. And as dismay grows over how slowly the money raised by the American Red Cross and other agencies is reaching victims' families, we are learning again that it's much easier to give than to give well. With that in mind, I contacted several Wall Streeters who, like Leventhal, have both money and experience in giving effectively.

They've all made mistakes. "The biggest is not doing the homework," said Jack Brennan, chairman of mutual-fund giant Vanguard Group. It's not just checking how efficiently a charity runs, but also weighing who needs money most. Doing that right now is especially hard, Brennan noted, as charities face bear markets, recession, and diversion of attention to September 11 relief—"the perfect storm for non-September 11-related charities."

This is why Brennan and his wife, Cathy, focus on a few causes, among them United Way, public broadcasting, and a couple of human-services agencies near their Main Line Philadelphia home. "You have a greater ability to make a difference

if you're giving 10X rather than x," he said.

Giving big can backfire, though. Foster Friess, veteran manager of Brandywine Funds, recalls that he and his wife, Lynn, "wanted to back a church to start a drug-rehab center. We sent them a quarter-million bucks up front, and they wound up buying a building. They didn't have enough left over for staff."

Instead, Friess has learned to fund low-cost, "entrepreneurial" chari-

ties with measurable results. One was started by Thomas Scott, a Wilmington (Del.) physician who was near retirement when he began treating the indigent in a mobile clinic he set in a van. On the success of that model, Friesses have funded vans in six more cities where local doctors donate services, with more to come. "We can get a report of how many earaches were attended to and see how many dollars were spent and what the return on that was," he said. "If you give \$1,000 to a school kitchen, you ought to know how many people

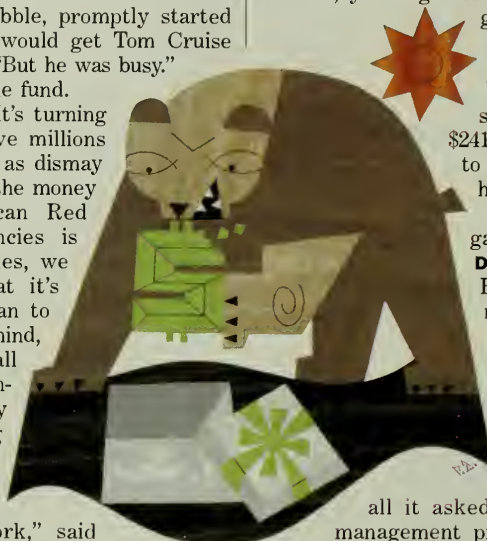
got fed." Friess also knows to donate appreciated assets, when possible. In October, when he sold 51% of his firm for \$241 million, \$56 million went to three charities he had given stock. That saved millions in capital gains taxes.

DELI HELP. Even Claude Rosenberg, a retired money manager with a second career as philanthropist and chairman of NewTithing Group, says he and his wife, Louisa, married a couple of years ago in giving a Berkeley (Calif.) music ca-

reer. "They ran into management problem, and I think probably jumped too fast." At NewTithing, Rosenberg is devoted to showing well-off people that they can give much more and still be plenty rich.

The most recent study by NewTithing found the well-off can afford in 2001 to donate an extra \$127 billion (table), even given a 25% drop in investment assets this year. NewTithing's model assumes the wealthy can comfortably donate 0.75% to 3% of assets, depending on wealth. For instance, it figures the average taxpayer with an adjusted gross income of \$200,000 to \$500,000 can afford to give 0.75% of assets.

Yet it need not be all about money. Although Leventhal did not give to the September 11 Fund, she got busy when she saw the woes of a nearby deli, Maxwell's Annex, that had kept closed weeks longer than other businesses because of its location. "I e-mailed every company that I knew in this building, other friends that I knew in the neighborhood, and said, 'Hey, they've been closed for six weeks, it's only now dealing with what we all went through emotionally. On top of that, he's got this business to keep alive. Everybody, go eat there.'" I asked the deli's owner, David Meyers, about this. He confirmed it. The deli's voice grew thick. He said: "She's a doll."



UNTAPPED POTENTIAL

Retired money manager Claude Rosenberg's NewTithing Group estimates that even after this year's steep financial-market losses, high-income Americans could comfortably donate much more to charity.

ADJUSTED GROSS INCOME	ACTUAL AVERAGE DONATION*	AFFORDABLE 2001 DONATIONS**
\$100,000 TO \$199,999	\$3,156	\$4,500
\$200,000 TO \$499,999	7,558	16,000
\$500,000 TO \$999,999	18,260	70,000
\$1 MILLION OR MORE	122,940	690,000

*In tax year 1998, the latest Internal Revenue Service data available.

**Assumptions spelled out at www.newtithing.org

Data: NewTithing Group

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CDI SNIFFS AN UPTURN



BY GENE G. MARCIAL

Job-recruiter CDI is perking up—so will the economy follow? For now, Panera Bread is rising nicely. And the buzz is good on a Genentech cancer treatment

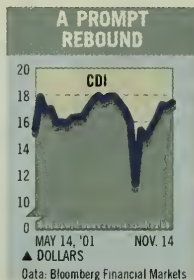
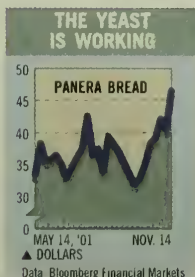
With unemployment on the rise, this is a bad time to get into the job-placement business, right? So why is Big Board-listed CDI (CDI), which supplies techies to the blue chips, shooting up? Between Sept. 2 and Nov. 14, shares rose from 11 to 17.25—a 54% climb. Yet business has been terrible: In the third quarter, revenues were 19% below last year, and CDI posted a loss. And some analysts expect worse in the first half of 2002.

But value investor Mark Boyar, who has accumulated 147,500 shares, argues that staffing outfits are often the first to catch a whiff of a coming turnaround. The stock market usually presages an economic upturn six months ahead—and shares of CDI may be doing just that: forecasting a recovery in the next couple of quarters. Boyar insists that CDI will surprise investors with an earnings rebound in the first or second quarter. “This is one reason why CDI is moving up,” says Boyar.

There is another factor behind the stock’s buoyancy: a potential buyout. CDI Chairman Walter Garrison, 75, who owns 8.7% of the stock, is said to be inclined to sell the company once it gets back on its former growth path, says Boyar. Insiders control 40% of the equity, he adds, which would be worth twice its current price in a buyout. “We don’t believe that keeping CDI in its current form is of critical importance” to Garrison, says Boyar. “More likely, he simply wants to see his personal fortune return to levels reached in 1998”—when CDI was trading somewhere in the 40s. New CEO Roger Ballou has been cutting costs to boost profitability. Garrison did not return calls for a comment.

AN ENTICING AROMA FROM PANERA BREAD

Panera Bread (PNRA), which owns and operates about 330 bakery-café in 28 states, is your typical Peter Lynch stock. He favors rapidly growing companies in businesses that consumers are familiar with, such as Panera—a well-managed restaurant catering to families. Panera has heated up from 30 on Sept. 10 to 46 on Nov. 14, after having been as low as 11 in January. Lynch, star spokesman for Fidelity Investments and its former ace stock picker, holds nearly 5% of the stock in his personal portfolio. The Richmond Heights (Mo.) company, which once owned the Au Bon Pain chain, serves its own brand of



bread and other food—at an average check of \$12 compared with \$12 at rival eateries.

The company handily beat Street estimates with its record third-quarter sales and earnings results. Annualized sales for company-owned and franchised restaurants climbed 6%, to \$1.7 million. This year, Panera opened 70 new restaurants—at which the average sales were even higher, running at an annual rate of about \$1.9 million. It plans to up its restaurant roster to 455 in 2002—128 company-owned and 327 franchised.

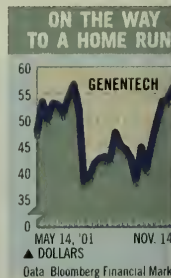
So analyst Selman Akyol of investment firm Stifel Nicolaus, who rates the stock a buy with a 2001 price target of 50, raised his 2001 earnings estimate to 87¢ a share, on sales of \$198.8 million and his 2002 numbers to \$1.22 and \$243.5 million. Last year, Panera earned 52¢, on sales of \$151 million. Akyol boosted his estimates based on new openings and continued strong same-store sales.

GENENTECH PASSES SOME TOUGH TESTS

Biotech is the way to hit home runs. So says Joseph Battipaglia, chief investment officer at Gruntal, who is high on companies involved in cancer treatment. Some products approved in recent years—such as Genentech’s Rituxan, he notes—are highly specific, targeting cancer cells directly. And they are far less toxic than chemotherapy or radiation.

This is one reason he has accumulated shares of Genentech (DNA), a major biotech company whose other products include Herceptin, used for the treatment of metastatic breast cancer. Although Genentech has been on the rise—from 38 on Sept. 10 to 55 on Nov. 14—Battipaglia sees it spiking again soon: Genentech will present a paper at the Dec. 7-10 conference of the American Society of Hematology. The buzz is that it will detail favorable two-year test data on its top-seller, Rituxan, a monoclonal antibody for non-Hodgkin’s lymphoma. Rituxan was the first such treatment licensed for cancer. Sales rose from \$279 million in 1999 to \$444 million last year. Battipaglia, who sees the stock hitting 64 in 18 months, expects the positive data to stir up fresh interest in Genentech.

So far, Rituxan is approved for use only in late-stage patients. “Rituxan’s improved efficacy in the post-approval test should help justify Genentech’s request for expanded use,” says John McCamant, editor of *Medical Technology Stock Letter*. “This is a big deal for Rituxan.”



BusinessWeek online

Read Gene Marcial’s Inside Wall Street Online column Tuesdays afternoons at www.businessweek.com/today.htm. And see it Fridays at 1:10 p.m. EST on CNN’s *The Money Gang*.

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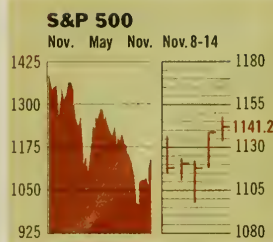
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COMMENTARY

Equity markets rose this week, buoyed by good news from Afghanistan, where the Northern Alliance made big gains against the Taliban, and the U.S. economy, where October retail sales soared 7.1%. The Nasdaq, Dow Jones Industrials, and the S&P 500 rose 3.6%, 2.8%, and 2.3%, respectively. All three indexes are now above their pre-September 11 levels.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Nov. 14	Week	Year to date	Last 12 months
S&P 500	1141.2	2.3	-13.6	-17.5
Dow Jones Industrials	9823.6	2.8	-8.9	-8.0
Nasdaq Composite	1903.2	3.6	-23.0	-39.4
S&P MidCap 400	480.2	1.7	-7.1	-4.6
S&P SmallCap 600	214.3	2.4	-2.4	0.6
Wilshire 5000	10,510.9	2.3	-13.7	-18.2

SECTORS

	Nov. 14	Week	Year to date	Last 12 months
BusinessWeek 50*	749.3	2.7	-22.8	-31.6
BusinessWeek Info Tech 100**	412.4	3.2	-27.1	-45.4
S&P/BARRA Growth	591.8	2.2	-13.9	-23.5
S&P/BARRA Value	549.0	2.3	-13.7	-11.9
S&P Energy	790.3	-1.7	-15.2	-14.1
S&P Financials	146.6	1.8	-11.0	-5.6
S&P REIT	90.8	1.7	3.2	11.4
S&P Transportation	655.4	1.9	-6.1	-4.4
S&P Utilities	249.2	2.4	-28.9	-21.8
GSTI Internet	100.7	10.4	-44.5	-66.9
PSE Technology	669.5	2.4	-17.8	-28.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Invest. Banking/Bkrgr.	20.6	Specialty Printing 56.0
Transportation Services	20.1	Paper Containers 48.7
Semiconductors	19.8	Engineering & Constr. 45.5
Apparel Manufacturing	17.8	Toys 41.7
Department Stores	17.7	Tobacco 38.0

GLOBAL MARKETS

	Nov. 14	Week	Year to date
S&P Euro Plus (U.S. Dollar)	1048.8	1.0	-26
London (FT-SE 100)	5240.7	0.5	-15
Paris (CAC 40)	4575.1	1.8	-22
Frankfurt (DAX)	4953.5	1.9	-23
Tokyo (NIKKEI 225)	10,086.8	-1.9	-26
Hong Kong (Hang Seng)	10,950.0	6.6	-27
Toronto (TSE 300)	7349.5	2.9	-17
Mexico City (IPC)	5751.7	2.0	1

FUNDAMENTALS

	Nov. 13	Wk. ago
S&P 500 Dividend Yield	1.37%	1.40%
S&P 500 P/E Ratio (Trailing 12 mos.)	45.2	45.8
S&P 500 P/E Ratio (Next 12 mos.)*	21.7	21.2
First Call Earnings Revision*	-6.55%	-7.11%

*First Call Corp.

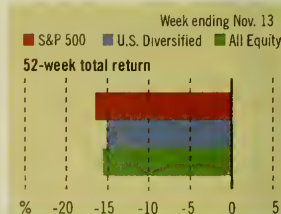
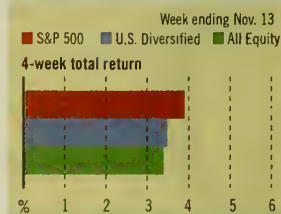
TECHNICAL INDICATORS

	Nov. 13	Wk. ago
S&P 500 200-day average	1191.5	1197.3
Stocks above 200-day average	45.0%	43.0%
Options: Put/call ratio	0.70	0.69
Insiders: Vickers Sell/buy ratio	1.35	1.52

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Photography/Imaging	-23.1	Communications Equ. 43.0%
Natural Gas	-19.9	Defense Electronics 43.0%
Engineering & Constr.	-13.3	Computer Systems 43.0%
Defense Electronics	-10.2	Photography/Imaging 43.0%
Long-Dist. Telecomms.	-10.1	Natural Gas 43.0%

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Technology	10.8	Precious Metals	30.8
Diversified Emerging Mkts.	7.1	Real Estate	12.9
Pacific/Asia ex-Japan	6.8	Small-cap Value	10.6
Latin America	6.7	Mid-cap Value	7.7
Laggards		Laggards	
Japan	-4.4	Technology	-49.5
Utilities	-2.3	Communications	-47.0
Precious Metals	-1.5	Japan	-38.4
Real Estate	0.1	Diversified Pacific/Asia	-30.1

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
ProFunds UltraOTC Inv.	24.0	Potomac Internet Short	94.7
Firsthand E Commerce	21.5	Schroder Cap. Ultra Inv.	77.8
Pilgrim Russia A	21.4	CGM Focus	67.4
PIMCO Global Innovation C	19.8	Monterey DCM Gold	52.1
Laggards		Laggards	
ProFunds UltraShort OTC	-24.6	ProFunds UltraOTC Inv.	-82.5
Rydex Dynamic Vent. 100	-23.0	Berkshire Focus	-78.0
Potomac OTC Short	-12.5	Berkshire Technology	-77.8
Potomac Internet Short	-10.4	Merrill Lynch Focus Twenty B	-77.4

Interest Rates

KEY RATES

	Nov. 14	Week ago
MONEY MARKET FUNDS	2.34%	2.53%
90-DAY TREASURY BILLS	1.86	1.78
2-YEAR TREASURY NOTES	2.68	2.29
10-YEAR TREASURY NOTES	4.52	4.18
30-YEAR TREASURY BONDS	5.02	4.79
30-YEAR FIXED MORTGAGE†	6.47	6.37

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 31% federal tax rate.

	10-yr. bond	30-yr. bond
GENERAL OBLIGATIONS	3.94%	
TAXABLE EQUIVALENT	5.71	
INSURED REVENUE BONDS	4.16	
TAXABLE EQUIVALENT	6.03	

THE WEEK AHEAD

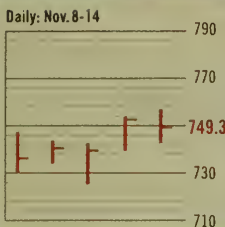
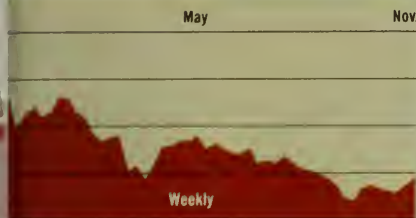
NEW RESIDENTIAL CONSTRUCTION *Monday, Nov. 19, 8:30 a.m. EST* ► Housing starts in October are forecast to decline to an annual rate of 1.52 million, after a better-than-expected pace of 1.57 million in September. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. So far, housing has shown few signs of weakening.

INTERNATIONAL TRADE *Tuesday, Nov. 20, 8:30 a.m. EST* ► The trade deficit proba-

bly narrowed to \$25.3 billion in September, from \$27.1 billion in August. The September 11 attacks likely caused a record drop in imports, due to border and port interruptions and large claims payments by foreign reinsurers.

LEADING INDICATORS *Tuesday, Nov. 20, 10 a.m. EST* ► The Conference Board's October composite index of leading economic indicators probably slipped 0.2%. In September, the index declined 0.5%, the largest drop since 1996.

FEDERAL BUDGET *Wednesday, Nov. 21, 11 a.m. EST* ► The U.S. Treasury will report an October deficit of \$14 billion compared with a deficit of \$11.3 billion in October, 2000, and a surplus of \$35.4 billion in September. For fiscal year 2001, which ended Sept. 30, U.S. Treasury ended with a surplus of \$127.2 billion. Excluding Social Security, however, it ran a deficit of \$33.5 billion. Fiscal 2002 will likely parallel 2001, with more tax cuts and large amount of economic stimulus spending.

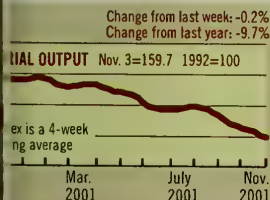


l performance for the BW 50, which rose 2.7% for the week. Energy companies lit up the list: Dynege, quiring the troubled Enron, leapt 40.0%, while Calpine rose 12.4%. Financial giants, such as Mor-up 8.1%, and Merrill Lynch, 5.9%, as well as tech leaders AOL Time Warner, up 10.7% and Tellabs, enefited from investor optimism on the economy.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	6.7	3.7	26	Verizon Communications	-1.2	1.7
Ko Petroleum	-3.3	-13.1	27	Citigroup	4.9	3.7
	12.4	-38.1	28	Sun Microsystems	5.0	-34.1
	40.0	-1.5	29	Merck	0.2	-18.6
Materials	3.5	-10.2	30	El Paso	6.8	-29.8
an Financial	32.9	-92.6	31	Altera	0.7	-2.5
ntal Petroleum	-2.1	4.1	32	Marsh & McLennan	3.2	0.5
	-5.0	-18.7	33	Household International	3.7	4.3
Ge	-4.2	-17.2	34	ChevronTexaco	-0.8	-0.3
	-4.2	-30.2	35	SBC Communications	-1.6	-17.7
Brothers Holdings	5.9	4.4	36	Mercury Interactive	5.9	-47.4
	3.5	-63.8	37	AOL Time Warner	10.9	-13.1
	15.4	-72.7	38	Washington Mutual	2.7	-5.8
Laboratories	-7.5	1.2	39	General Dynamics	-3.0	18.5
ston Financial	3.5	-9.0	40	Comcast	1.0	-12.6
Technology	7.2	-22.7	41	Morgan Stanley Dean Witter	8.1	-8.5
	-0.3	-8.9	42	Tellabs	9.2	-64.7
la Hess	-2.2	-21.3	43	Exxon Mobil	-1.0	-4.9
ergy	1.0	-8.6	44	Scientific-Atlanta	2.4	-48.9
ecommunications	24.7	-57.6	45	U.S. Bancorp	-0.5	-21.5
One Financial	9.5	-2.3	46	Paychex	5.8	-7.1
Petroleum	-4.0	-0.1	47	Merrill Lynch	5.9	-13.5
Devices	3.2	13.3	48	Bed Bath & Beyond	9.1	26.7
sources	-3.6	-22.1	49	Texas Instruments	6.4	4.6
il Health	2.7	-1.7	50	Teradyne	4.9	-11.3

Production Index



on index slipped lower for the week. Before f the four-week moving average, however, e for the first time in five weeks, to 159.8. On a seasonally adjusted basis, autos, bles, steel, coal, and rail-freight traffic er for the week. Crude-oil refining fell, as economy pushed U.S. West Texas crude oil \$20 per barrel—the lowest price in over two c power and lumber also declined.

each of the index components is at www.businessweek.com.
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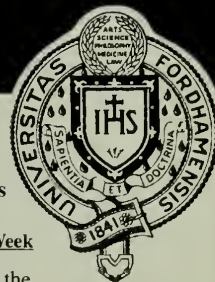
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END THE NUMBERS GAME

What did the company earn? That's the most basic question an investor can ever ask. The equity culture that has generated so much growth over the years depends on a clear answer, but getting one has become impossible. Enron Corp. just announced that its earnings for the past three years were overstated by half a billion dollars. How did one of the biggest companies on the New York Stock Exchange manage to inflate its earnings by 20% without auditors, analysts, ratings agencies, and the business press (*BusinessWeek* included) discovering it? In part, blame the breakdown of standardized accounting rules and the anarchy that runs rampant in the financial statements of Corporate America. The U.S. needs a new set of accounting rules that gives a clear picture of financial performance. Without integrity in financial reporting, the U.S. cannot hope to remain the preeminent place to invest in the global marketplace (page 76).

The dot-com bubble was the first indication that there was something seriously wrong with accounting standards. Companies without much of a business model customized their quarterly statements to exclude a grab bag of expenses in order to put a positive financial spin on their operations. Wall Street conspired in this and encouraged big companies to join in. Soon, the method of calculating earnings began to vary from company to company and even from

quarter to quarter within a company. It is now cha

A stricter adherence to accounting rules won't solve the tire problem. GAAP, the generally accepted accounting principles, allow all kinds of one-time expenses and noncash charges. This obscures the performance of ongoing operations. No one can fathom what are true operating earnings because there are no guidelines as to what constitutes an extraordinary expense. The result is total confusion. Take earnings per share for the Standard & Poor's 500-stock index for the second quarter. Under Thomson Financial/First Call standards, it's \$11.82. But it's \$9.02 according to S&P and \$4.83 under GAAP. How can investors make intelligent decisions?

The Financial Accounting Standards Board clearly is failing to do its job. It has promised to write a set of rules that calculates operating earnings and relates them to net earnings, but it hasn't delivered. The rating agency Standard & Poor's (owned by The McGraw-Hill Companies, as is *BusinessWeek*) is doing a better job. It recently drew up a definition of "operating earnings" that includes restructuring costs (including severance), writedowns from ongoing operations, and the cost of stock options. It excludes merger and acquisition expenses, litigation settlements, impairment of goodwill, and gains or losses on asset sales. This is a beginning that FASB should build on. The accounting anarchy has to end.

THE CASE FOR ECONOMIC OPTIMISM

The great fear was that the shock of September 11 coupled with the insidious anthrax threat would cause American consumers to "turtle"—draw back into their shells and stop spending. The blows came as the economy was already weak and conventional economic wisdom predicted that people would lose confidence. War and recession, after all, make for gloom and doom. But just as surprising victories on the military front have given reason to be more optimistic about the war, there may be cause for hope about the economy: A number of "victories" on the economic front may add up to the beginning of the end to recession.

Here's the case for economic optimism. October retail sales bounced back from the trauma of September, proving conventional wisdom wrong: They rose 7.1%, more than three times what economists anticipated. Sales of autos, powered by zero-interest loans, were huge; clothes, building materials, and restaurants also did well (page 33). So the worst may be over. Consumer sentiment has turned around. The University of Michigan survey of consumer attitudes showed a strong rise so far in November. The dollar has stopped falling. It has gone up about 4% against the euro in the past two months. The stock market has improved: The S&P 500 is up 18% over the past eight weeks, and even battered tech stocks are rising. Most important, corporate

earnings may be reaching bottom. Standard & Poor's estimates a 4.4% increase in third-quarter earnings per share over the second quarter. That's quite a lot of good news.

There's more. Rising interest rates and oil prices, which flattened the economy a year ago, are now in full reverse. Oil is down about 20% in the past two months and mortgage rates have fallen so far that they are near their 1990 lows, triggering a huge wave of refinancing. The money supply is strong, and businesses as well as families are reliequifying their balance sheets. Finally, productivity growth remains remarkably healthy, helping corporations rebuild their bottom lines.

There's still bad economic news. Consumer confidence is fragile and could deteriorate with further terrorist activity. High-tech investment is dormant. The airline industry is in serious trouble. Japan is sinking into recession again. Inflation talk is in the air. And many stock valuations remain high by historic standards.

The one big question mark is the \$100 billion federal stimulus bill that is still stuck in Congress. The politicians must get over their partisan wrangling and get the money flowing before the Christmas season begins. There is a good case to be made for economic optimism and, with a little luck, it could get stronger.

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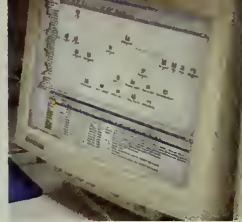
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Ready for an Encore?

As the curtain descends on a dismal year, some investors see the telecom gear-maker—and CEO Jozef Staus—as a star with comeback potential



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Up Front

EDITED BY SHERIDAN PRASSO

PERK PARADE

MEMO: HOLD THE HOLIDAY CHEER

THE SOUR ECONOMY HAS Corporate America playing Scrooge this holiday season, revoking all manner of employee perks, from the lavish to the mundane.

In mid-November, Credit Suisse First Boston, to save some \$400 million over three years, did away with hundreds of millions' worth of pay guarantees for about 350 stars, including Frank Quattrone, head of technology investment banking. And as of Jan. 31, 400 top CSFB executives will lose their company cars. In October, Ford Motor stopped handing out free PCs and \$5-a-month Internet access to its 346,000 workforce. Half of Ford's employees had signed up in time; they won't have to give back the computers,



SCROOGE: Bye-bye, parties

but must pay the access fee.

Now employers are reconsidering that last remnant of company-sponsored excess: the holiday party. Half of the 150 companies surveyed by search firm Battalia Winston International say the weak economy has made them reconsider the fetes. Of those, 86% will hold more modest gatherings, while 18% are canceling them altogether. In this environment, it seems even holiday parties can get downsized. *Kimberly Weisul*

mere 4% of respondents plan to buy from e-tailers rather than stores because of terror worries. To top it off, only 35% of consumers who already did some holiday shopping online were "very satisfied."

Clearly, the thrill is gone. Ironically, the appeal of e-tailers could be suffering simply because they're trying to do the right thing: make money. They're cutting free goodies as well as services and staff to handle e-mail and phone calls. Shoppers expect to increase their online holiday budget only slightly, to 15% from 13% of total spending.

But at least things are a little better now: 17% of last year's online shoppers were more satisfied this year. That's better than some merchants expected, says Sean Kaldor of Nielsen//NetRatings. In other words: Things could be worse. *Heather Green*

TALK SHOW "Attention people of Afghanistan! Up to \$25 million reward is being offered for information leading to the location or capture of Osama bin Laden."

—U.S. reward announcement broadcast into Afghanistan

SMOKE ALARM

WHERE THE TOBACCO DOUGH IS GOING

WHEN BIG TOBACCO AGREED to pay the 50 states \$246 billion in settlements a few years ago, the antismoking crowd hoped the money—to be paid out over 25 years—would be spent on preventing teen smoking and covering health-care costs.

But that's not happening. A National Conference of State Legislatures study found most of the money, 63.4% of the \$21.3 billion paid so far, is going elsewhere, to everything from tax cuts to pork-barrel projects. Only 5% has gone to smoking prevention, and 31.6% to health care. The Centers for Disease Control & Prevention give 43 states failing grades on adequate tobacco education. Says CDC policy analyst Melissa Albuquerque: "Our goal is for all states to meet the guidelines." The CDC says 23.5% of adults smoke. It would like to see that drop to 12%.

In Illinois, lawmakers have used the tobacco windfall to help give residents \$280 mil-

lion in property-tax relief. North Dakota is using nearly half its proceeds for water projects, including \$52 million to build dams on the F River. Iowa used \$6.4 million of \$117 million in last year's payments to expand the state penitentiary by 200 beds at \$10.3 million for a new building. Others simply use the money to balance the books. Tennessee, for instance, covering all of its \$560 million deficit with tobacco money.



NO EDUCATION? Teen smokers

The states say the settlement terms don't restrict how funds are to be used. While critics say states are morally bound to use the money for antismoking efforts, Lee Dixon of the National Conference notes that "states are free to determine how the dollars should be spent."

Ushma Patel and Aixa M. Pascual



WEB WATCH

E-TAILERS FEEL A HOLIDAY CHILL

E-TAILERS WON'T GET ANY breaks this holiday season. A November survey of 500 online shoppers by Harris Interactive, Goldman Sachs and Web rating service Nielsen//NetRatings torpedoed speculation that consumers would skip malls and shop online instead post-September 11. A

THE LIST IN JUST 17 SYLLABLES

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INDUSTRY POUNDED IN OCTOBER, WORST SINCE FEBRUARY, 1991

HAIKU

The cockpit other than the accident sequence missing on the ground

Afghanistan is the end of Taliban rule the Taliban was

It's another nail the leaner inventories offer cold comfort



Data: www.headlinehaikus.com

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Up Front

WAR RUMBLINGS

HOLLYWOOD ROLLS OUT ITS BIG GUNS



BLACK HAWK DOWN: Early

AMERICANS, IT SEEMS, ARE IN a mood to fight back. That's the message Hollywood is getting from screenings of upcoming war movies. Even as studio execs met with the Bush Administration on Nov. 11 to discuss cooperative patriotism, studios were rushing war films to theaters.

That's a change from immediately post-September 11, when execs yanked movies that might further rattle a traumatized nation.

Fox has moved up *Behind Enemy Lines*, starring Gene Hackman, from Jan. 18 to Nov. 30. "A kick-ass film is a good thing to have right now," says Fox Filmed Entertainment Chairman Tom Rothman. Fox beat Sony's *Black Hawk Down*, a big-budget film depicting the 1993 U.S. military raid in Somalia. Originally set to open in March, it gets limited release on Dec. 28, going national on Jan. 18. Sony thinks the heroic tale will resonate, even though 18 soldiers die.

Hollywood couldn't help but notice that rentals were booming for films such as *Die Hard*, in which Bruce Willis mows down German terrorists. With the Taliban on the run, Hollywood is pulling out its own big gun. In *Collateral Damage*, at first postponed and now due out in early 2002, Arnold Schwarzenegger will hunt down terrorists who killed his family. *Ron Grover*

FUND WATCH

IT'S TRUTH-IN-LABELING FOR WALL STREET

WHAT'S IN A NAME? PLENTY, if you're a mutual fund. A new Securities & Exchange Commission rule will require funds to have at least 80% of their assets—up from 65%—in investments that reflect what the funds are called. Thanks to shifts in style and a volatile stock market, expect lots of name changes before the rule goes into effect next summer. A few have changed already:

■ Scudder's \$404 million Small-Cap Equity Fund becomes the Dynamic Growth Fund—since only about half its holdings are in small-caps.

■ Strong Capital's \$264 million American Utilities Fund becomes the Dividend Income Fund. Just 68% of holdings are now in utilities.

■ Invesco's Blue Chip Growth Fund becomes just Growth Fund: Its \$2 billion is 60% invested in technology stocks, which seem less "blue chip" now than they used to.

Of course, funds can have names with no relation to any investment style. There are no plans, for example, to alter Fidelity Investments' flagship Magellan Fund. *Kimberly Weisul*



DRAWN & QUARTERED



WHERE'S THE BEEF?

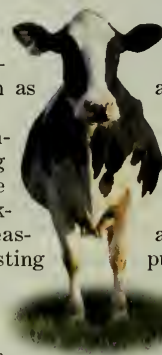
CALL IT CATTLE-LOGGING

SHAKEN BY THE FIRST CASE of mad cow disease in Japan, consumers have been shunning traditional beef dishes such as *shabu-shabu* and non-traditional ones such as McDonald's burgers.

Now, the government, after bungling its mad-cow response in September, is taking measures to reassure the public—testing all slaughtered cows, and assigning 10-digit identity codes to Japan's 4.5 million bovines. Japan had begun a slow rollout of the \$28.3 million plan, modeled on one in Europe, before the panic. But now it will speed it up, com-

pleting it by next April instead of 2004. In the 21st century's answer to cattle branding, plastic tags with bar-coded ID numbers will be clipped to cows' ears to record their age, breed, location, and place of birth.

Oddly, the government will have a better idea of the whereabouts of cows than taxpayers. National ID numbers for humans won't be issued until next August, three years after passage of a controversial bill. The public has long opposed IDs for fear the government might abuse its power. "Japanese people just don't like the idea of being identified by a number," says an agricultural ministry official. "But the cows don't see to mind." *Chester Davis*



THE BIG PICTURE

READY FOR THE WORST?

Faced with warnings of continued terrorism, Americans are unconvinced the government can keep them safe.

PERCENT WHO SAY GOVERNMENT IS "VERY" OR "SOMEWHAT" PREPARED TO

GUARD AGAINST MISUSE OF CROP DUSTERS 53%

VACCINATE AGAINST BIOLOGICAL AGENTS 50%

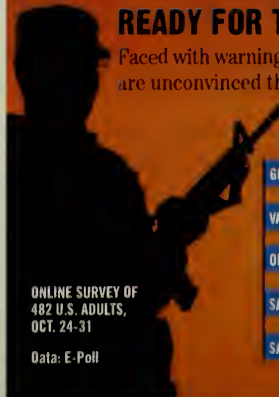
DETECT A BIOCHEMICAL ATTACK 47%

SAFEGUARD WATER SUPPLIES 41%

SAFEGUARD MAIL 27%

ONLINE SURVEY OF 482 U.S. ADULTS, OCT. 24-31

Data: E-Poll



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THE U.S. AND RUSSIA: A FEW HURDLES REMAIN

Vladimir Putin has a good reform record and deserves continued Western support ("Putin's Russia," Cover Story, Nov. 12). One of the biggest challenges remaining before him, however, is reform of the legal system. Commercial laws designed to hold business partners to their promises are essential to sustained foreign investment. Putin has repeatedly pledged sweeping reform of Russia's corrupt and complex judicial system but has not delivered.

Russian Prosecutor-General Vladimir Ustinov, whose office is often accused of stalling, recently recommended against speedy reform of the legal system. Regional leaders still take advantage of the courts' irregular budgeting to "buy" particular judges or courts.

Companies having tax disputes with local authorities may take some comfort in the fact that, under the new criminal-procedure code, a court order is needed to arrest foreign executives. Up until now, prosecutors could decide the fate of the unsuspecting business traveler. Let us hope Putin can deliver more than that.

Tom Muellenbach
Rochester, N.Y.

A caption accompanying the photograph of graduate student Andrei Isserov reads: "Student Isserov doesn't want Russia to become a U.S. clone." I would like to remind the young Isserov that Slovakia (a part of the former Czechoslovakia) was "liberated" by the Red Army in 1945 and was later occupied by the same army in 1968, suppressing our effort to become a free

and democratic country. Should Russia not help us to recover from this depression, which lasted for 43 years?

Student Isserov should read a lot of history books: He will see that it is better to be a U.S. clone than a Russian (Soviet) one. The biggest problem that Russia expects help from even one outside Russia and doesn't see that change must come from within.

Miroslav Palke
Bratislava

I am surprised that neither the Bush Administration nor *BusinessWeek* has suggested cooperation between the U.S. and Russia in developing a missile defense system. Russia

has relevant capabilities and technologies, and we share a common threat.

What's the problem—politics?

Overton Caperton
Grass Valley, Ca

NATIONAL IDs AND OTHER SECURITY MEASURES CAN WORK

I'm sick of hearing fears of what might be lost with new surveillance proposals—when we know what already has been lost without them ("Privacy in age of terror," Cover Story, Nov. 5). The American system is resilient enough to adapt to and prevent any costs we may face. Put down your doomsaying security books, and stick to what we know. Implement these measures now.

Brian Smith
London

Lorraine Woellert and Paul Magnusson base their commentaries on a basic fallacy: the assumption that the ID cards need to contain any information at all ("National IDs won't work" and "Y



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CORRECTIONS & CLARIFICATIONS

In the *BusinessWeek/Architectural Record* awards (Nov. 5), a photo illustrating the award-winning Corning Museum of Glass depicted an original building that was re-tornished in the project, but not the new building, which appears below, by Smith-Miller+Hawkinson Architects.



In the same package, the correct name of the structural engineering firm involved with the new Rockefeller University bridge should be Weidlinger Associates Inc.

...y certainly will," Cover Story, Nov. 5). Let us assume a card that contains only a person's ID number, with a secret code consisting of n-digits for positive identification of the individual. In the ID card reader is a microchip that describes information accessible to this reader. The information itself is carried in a central database. The card is inserted into the card reader. The ID number on the reader identification are transmitted to the central database, and the globally accessible information is transmitted back to the reader. Simple. Practical. Low-cost.

Harry Y. Snyder
Redlands, Calif.

IN THE WAR, USING MAD. AVE. AND GUERRILLA TACTICS

The war against terrorism can be compared to the cold war: competing ideologies, not easily defined; enemies thin and outside the U.S.; domino theory; and containment strategy ("A rest of friendly fire," News: Analysis & Commentary, Nov. 12). Considering it took nearly 50 years for the postwar world to get rid of the communist ideological appeal and expansion threat, we must do all we can to speed up the process of restoring a stable order for the Islamic world and eliminate its terrorist component and threat.

The war against terrorism, however, cannot be won on military terms only. The mind and soul of the Islamic world must be won over. We managed to sell the world on Coca-Cola and Marlboro.

Surely we can sell them on the value of freedom, democracy, human rights (especially for women), and education. Instead of funneling billions of dollars toward the weapons industry, we could take a portion of that money to Madison Avenue for a worldwide promotion of all the values we stand for.

Raphaël Monnot
Paris

HERE COME THE LAWYERS, IN ALL THEIR GREED

While trial lawyers hide behind consumers and talk about how the airlines and the federal government should be sued so victims can be compensated, they're also making sure their own interests are being looked after ("September 11: Here come the trial lawyers," Government, Nov. 12). Why else would they work so hard to make sure a provision was eliminated from the airline-bailout bill—that would have limited their fees to 25% of any award?

Michael Vallante
Citizens Against Lawsuit Abuse
Los Angeles

I was disgusted by the comment of New York lawyer Lee S. Kreindler. Why wouldn't we sue? he asks. "This is our livelihood." Following the attacks, for the first time in my 33 years, I felt as though the U.S. were truly "one nation, under God"—regardless of people's race, gender, or religious belief. Yet now there are people who want to profit from this tragedy. Litigation will not bring back the victims, but it could further weaken our economy and cause more negative repercussions throughout the nation, which is exactly what the terrorists wanted in the first place.

Leah Ackerson
Atlanta

How ludicrous that a terrorist event would bring out the scavengers. The lawyers would have us believe they are the only ones who can bring "fair" settlements into play. Let us hope that reforms occur before the lives so horribly lost on September 11 are diminished by the petty words of attorneys.

Carol Kiessig
Avila Beach, Calif.

KEN CHENAUT HAS HIS WORK CUT OUT FOR HIM AT AMEX

As a former employee of American Express Co., I would say this of Kenneth I. Chenault: As a leader, he is without parallel. He can inspire the ranks to do their best ("Tough times for a new CEO," Cover Story, Oct. 29). Nevertheless, some AmEx shortcom-

ings stand out: slow product development, plain-vanilla offerings, a card-centric mindset, and less-than-optimal customer service. Anyway, we all hope Ken Chenault can turn AmEx around.

B. Venkatesh
Princeton, N.J.

THE REAL STORY ON HEDGE FUNDS

Based upon nonsensical media coverage of a few hedge funds that made high-risk/high-reward investments and came out behind (although *BusinessWeek* has been more evenhanded than most), those of us in the industry have had to take on a bunker mentality, using little or no leverage and sticking to vanilla stocks and bonds ("Why those hedge funds are getting trimmed," Finance, Oct. 29). While we will no doubt continue to crush mutual funds (after all fees), a return to mind-boggling returns will require a wholesale attitude adjustment by many in the media.

Benjamin W. Shoval
New York City

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HARDCOVER BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	JACK Jack Welch, with John A. Byrne (Warner Business • \$29.95) <i>GE's ex-chairman reflects on his life and accomplishments.</i>	2	2	
2	WHO MOVED MY CHEESE? Spencer Johnson (Putnam • \$19.95) <i>Learning to accept change.</i>	1	34	
3	FISH! Stephen C. Lundin, Harry Paul, John Christensen (Hyperion • \$19.95) <i>Motivate employees the Pike Place Fish market way.</i>	3	14	
4	GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50) <i>How companies make the leap from run-of-the-mill to excellence.</i>	--	1	
5	FIRST, BREAK ALL THE RULES Marcus Buckingham, Curt Coffman (Simon & Schuster • \$26) <i>A Gallup probe into managerial success.</i>	7	30	
6	NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$26) <i>How to bolster your true talents.</i>	9	9	
7	GUNG HO! Ken Blanchard, Sheldon Bowles (Morrow • \$20) <i>How Walton Works No. 2 fired up its employees.</i>	8	31	
8	THE ROAD TO WEALTH Suze Orman (Riverhead • \$29.95) <i>Questions and answers from the queen of personal-finance counseling.</i>	5	4	
9	THE 21 IRREFUTABLE LAWS OF LEADERSHIP John C. Maxwell (Thomas Nelson • \$22.99) <i>A minister's down-to-earth rules.</i>	13	13	
10	TWIN TOWERS Angus Kress Gillespie (Rutgers • \$26) <i>The politics, physics, and popularity of the World Trade Center.</i>	6	2	
11	NICKEL AND DIMED Barbara Ehrenreich (Metropolitan • \$23) <i>How the working poor live.</i>	--	1	
12	THE AGENDA Michael Hammer (Crown Business • \$27.50) <i>Nine notions to fuel success in the customer economy.</i>	--	1	
13	RAVING FANS Ken Blanchard, Sheldon Bowles (Morrow • \$20) <i>Turning customers into your biggest boosters.</i>	15	38	
14	THE TIPPING POINT Malcolm Gladwell (Little, Brown • \$24.95) <i>Discovering what turns an idea into a hot trend.</i>	10	20	
15	THE 21 INDISPENSABLE QUALITIES OF A LEADER John C. Maxwell (Thomas Nelson • \$17.99) <i>Changing "from the inside out."</i>	--	3	

PAPERBACK BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	RICH DAD, POOR DAD Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$15.95) <i>Teach your kids the rules of money that the rich play by.</i>	1	30	
2	THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Fireside • \$14) <i>Habitually popular.</i>	2	81	
3	1001 WAYS TO REWARD EMPLOYEES Bob Nelson (Workman • \$10.95) <i>Give them a champagne brunch, casual dress day—or plain old cash.</i>	--	58	
4	GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14) <i>A Harvard team's step-by-step guide to conflict resolution.</i>	3	76	
5	THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkley • \$12.95) <i>Management techniques in story form.</i>	7	62	
6	THE LEXUS AND THE OLIVE TREE Thomas L. Friedman (Anchor Books • \$15) <i>Globalization and its discontents.</i>	6	11	
7	RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95) <i>Move from job security to independence.</i>	9	19	
8	BUILT TO LAST James C. Collins, Jerry I. Porras (HarperBusiness • \$16) <i>How 3M, Wal-Mart, and others became standouts.</i>	10	47	
9	THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i>	5	11	
10	LINCOLN ON LEADERSHIP Donald T. Phillips (Warner Books • \$13.95) <i>Maxims drawn from the life of Honest Abe.</i>	--	1	
11	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed • \$16.95) <i>The enduring job-search bible.</i>	4	12	
12	THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.99) <i>The simple ways of the wealthy among us.</i>	8	38	
13	RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$19.95) <i>Becoming rich, not merely comfortable.</i>	14	17	
14	THE E-MYTH REVISITED Michael E. Gerber (HarperBusiness • \$16) <i>Starting and maintaining a small business.</i>	--	9	
15	THE GOAL Eliyahu M. Goldratt, Jeff Cox (North River • \$19.95) <i>Eliminating bottlenecks.</i>	11	25	

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Reviews and more are available on AOL (Keyword: BW) or www.businessweek.com

ON THE RISE

DAVID OWEN'S SLENDER VOLUME ON Tiger Woods, *The Chosen One* (Simon & Schuster, \$21), is a worthy companion to another best-seller, Woods's own *How I Play Golf* (Warner Books, \$34.95). What we learn from *New Yorker* writer Owens is that, in raising an exceptional child, Tiger's parents instilled no out-of-the-ordinary values. They stressed such Boy Scout virtues as honesty, courtesy, patience, and discipline. "Tiger was made to be a good person," says his father. The moral: If you want to

play the way Tiger does, you better get conventional parents.

So whence Tiger's unusual stature? As you might already expect, Owen believes that his gift is the product of relentless practice, drive—and, of course, the thing that can never be learned, talent. Even if the book holds few surprises, Wood-it will still enjoy Owen's account, which also explores such themes as greatness and its burdens, race, athleticism, and Tiger's impact on the golfing profession.

BY KARIN PEKARCH

THEODORE REX
by Edmund Morris
Random House • 772pp • \$35

THE ROUGH RIDER, WARTS AND ALL

The first thing you notice about *Theodore Rex*, Edmund Morris' new biography of the Republican Roosevelt, is its voluminous supply of footnotes and bibliography. Indeed, Morris furnishes us with 177 pages of details on the factual basis of his work. Normally, an author doesn't have to prove that a book is meticulously researched. But Morris, who won a Pulitzer Prize in 1980 for *The Rise of Theodore Roosevelt*, seems determined to exorcise the ghost of *Dutch*, his controversial 1999 memoir of Ronald Reagan. Morris created characters and dialogue for *Dutch*, rendering the book useless as history. A smart man who learns from his mistakes, Morris in *Theodore Rex* reverts to what he does best: straight-on history.

The result is an enlightening and entertaining portrayal of an American original. The Roosevelt of *Theodore Rex* is not the universal icon invoked by today's spectrum of politicians—everyone from liberal environmentalists to maverick conservative Senator John McCain. Morris' T.R. is a nuanced character with warts not fit for Mt. Rushmore. On one hand, this Roosevelt is bold and visionary—in many ways defining the century America at the moment he became a world economic and military power. He's witty and literate, as well: a best-selling author, fluent in French and Italian. But the youngest man ever to serve as President also comes across as brutish bully and an impulsive egotist who nurses grudges and all too often speaks before he thinks. And while Roosevelt revolutionized the role of government by extending its reach into regulation of American business, conservation of nature, and protection of the health and safety of workers, he often proved far more cautious in deed than he was in word.

It is the contradictory impulses in Roosevelt that make *Theodore Rex* so interesting. These are captured with partic-

ular skill in the sections on race relations. Like nearly all other white Americans of his time, Roosevelt was a racist who believed African Americans as a group were inferior to European Americans. But he was also denounced by Southern senators because he was the first President to invite a black man (Booker T. Washington) to dinner at the White House and a black woman to another White House social event. He condemned lynching, and he refused to back down when racist demagogues sought to oust all blacks from patronage positions in Dixie. On the other hand, Roosevelt was so traumatized by the vicious backlash to his overture to Washington that he never invited the Alabama educator to dine again. And he refused to hear Washington's appeal to his cruel order dishonorably discharging a regiment of black soldiers after an incident in Brownsville, Tex.

Roosevelt's America was changing rapidly—economically and socially—just as the nation is now, at the turn of the 21st century. It was being transformed by new technology and a flood of immigrants. Like today's William H. Gates III, the Wall Street moguls, monopolists, and "robber barons" were targets of populist scorn. The GOP was dominated by reactionaries such as Senators Mark Hanna of Ohio and Nelson Aldrich of Rhode Island, who believed that laissez-faire capitalism should not be subjected to government oversight. Roosevelt detested the status quo "stalwarts" and wanted government to ensure fair competition. He was a reformer, but he was no radical. He was a forward-looking conservative who sought to preserve the capitalist system against threats from socialists and anarchists.

He wanted "a fair deal" for all, factory owners and workers alike. A pragmatist, he pushed for incremental reform.

At one point, Morris describes an exchange between T.R. and Senator Robert M. LaFollette, a radical populist from Wisconsin. LaFollette is pushing for tough curbs on business. "But you can't get any bill such as that through Congress," says Roosevelt. "That is not the first consideration, Mr. President," the Senator responds. "But I want to get something through," T.R. retorts.

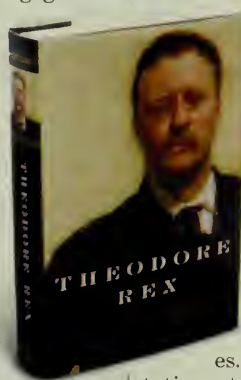
Morris obviously respects a President who "left behind a folk consensus that he had been the most powerfully positive American leader since Abraham Lincoln." And that despite being initially dubbed "His Accidency": He assumed power following the 1901 assassination of William McKinley. Morris' T.R. understood—and wanted to shape—the changing world order. He predicted the decline of Britain's empire and watched Japan's military ascension with admiration and foreboding. "I believe that Japan will take its place as a great civilized power of a formidable type," he said in the midst of the Russo-Japanese War. T.R. even forecast an eventual war between the U.S. and Japan.

On the economic front, he saw the need to protect capitalism from its own excesses. He pushed for the first sanitation standards for mass-produced food, protections for child laborers, shorter work weeks, federal mediation of labor disputes, and regulation of insurance. But he had a blind spot when it came to fiscal policy. With the U.S. credit structure near meltdown in the panic of 1907, T.R. gloated: "Do I look as though those Wall Street fellows were really worrying me?" No wonder, writes Morris, that J.P. Morgan, John D. Rockefeller, and other plutocrats felt he "was fiscally retarded."

Roosevelt was a man of profound accomplishments and great historical significance. The contradictions skillfully detailed by Morris only serve to enrich the portrait and enhance our understanding of a most important President.

BY RICHARD S. DUNHAM

Dunham covers the White House.



MORRIS' ROOSEVELT IS A WITTY VISIONARY BUT ALSO A BULLY, AN EGOTIST, AND A RACIST

SWIMMING ACROSS

A Memoir

By Andrew S. Grove

Warner Books • 290pp • \$26.95

THE STRUGGLE TO BECOME ANDY GROVE

If Andy Grove had grown up in America, who knows whether there would be an Intel Corp. today. As president of Intel in the mid-1980s, he was instrumental in a bet-the-company decision to abandon the memory-chip market—a huge business under attack by Japanese companies that produced better and cheaper chips. Intel could have stood its ground. Instead, it chose to focus on microprocessors, a much smaller business linked largely to the fledgling PC. Most of the U.S. companies that stuck with the memory business are now the stuff of trivia quizzes for tech buffs, while Intel is the world's largest chip company.

So what does the boyhood of Andrew S. Grove, chairman of Intel, have to do

with this? As told in *Swimming Across*, Grove's fascinating and moving memoir, his first serious dream was to be a writer, not a businessman. But the political repression in his native Hungary quashed his writing ambitions. Young Andris Istvan Grof devoured C.S. Forester's Horatio Hornblower series and Wild West novels by German writer Karl May. Inspired to try his own hand at writing, the 12-year-old published his occasional observations on daily life in a newspaper for young people. But one day, the Communist authorities in Budapest imprisoned Grove's uncle, a journalist, and the editors at the youth paper began rejecting Grove's articles. "You just don't write as well as you used to," the editors told him. Grove,

living through his second cycle of repression after the Nazi occupation during World War II, figured out that the real problem was his uncle's arrest. "My career in journalism suddenly lost its appeal," Grove writes.

A few years later, Grove tried fiction. He wrote a story entitled "Despair," based on the experiences of a close friend. Grove called it the most exciting moment of his life when his classmates and teacher loved the tale. But when he showed it to a famous writer in hopes of getting a recommendation for publication, Grove got back a terse note suggesting that the story be modified to reflect how, in real life, the Communist youth organization would have saved the protagonist from succumbing to despair. At that point, says Grove, "I was glad I liked chemistry."

And so chemistry it would be—leading to a career in the chip industry. But as formative as his literary misadventures were, Grove's personal tale, which stretches from boyhood to his arrival as a college graduate in California, contains more powerful anecdotes. At kindergarten in 1943, Grove and his Jewish classmates were so unaware of their heritage and the Nazi policies that



ey carried out mock persecutions. The children created a game by making a ring of chairs, then dragging selected children into the ring, chanting: "They'll put the Jews in the ghetto." It wasn't long before Grove understood that life was no game. His father, who had jointly owned and operated a thriving dairy business, "disappeared" while serving as a conscripted laborer in the army. Air raids became common. A summer interlude in the countryside cut short when word spread that the Germans were about to round up Jews in the area. "We don't serve Jews" signs began appearing in Budapest shops. Grove and his family had to wear yellow Stars of David. Finally, Grove and his mother went to live with friends outside of Budapest and blended with the Christian community. When the German soldiers were rejected by Russians after the war, the torment didn't cease. A soldier raped Grove's mother. His father miraculously returned, emaciated beyond recognition, but the Communist government nationalized his dairy business. Grove's father prospered for a while running a state laundry operation, before falling out of favor and being forced to find a new job at one-fourth the salary. Finally, with the Russian suppression of the

Hungarian uprising in 1956, Grove set out with another young friend on a perilous run, mostly at night, for the Austrian border. His escape to America is the most dramatic and compelling part of the book, heightened, like the rest of his story, by a spare, matter-of-fact tone.

Fortunately for Grove, the farmer who guided him to the Austrian border for a fee and the young Americans who cleared him for passage to his new home after an initial rejection were not the only helpers he encountered along the way. Teachers, in particular, provided him with plenty of encouragement. The title refers to a metaphor used by his physics teacher, who once told a room full of parents that life was like a lake and that all of their sons were trying to swim across it. "Not all of them will swim across. But one of them, I'm sure, will. That one is Grof." As Grove concludes his memoir, "I am still swimming."

Grove seems to spin his tale effortlessly, but it took a long time before

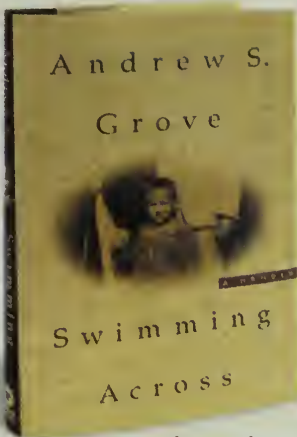
he would even consider telling it. Only when he was named *Time's* Man of the Year in 1997 did Grove finally reveal publicly a few snippets of his background. Frank McCourt's memoir, *Angela's Ashes*, helped inspire Grove

to tell his whole story. And both books strike the same chord—of surviving extreme adversity and ultimately being liberated by opportunities in America. McCourt's book is more literate, but Grove's may prove to be more in tune with the times. As his ship of Hungarian refugees entered New York harbor, Grove surveyed the city before him. "These houses have not heard bombs or artillery, not ever. I marveled at this." Those

houses have now confronted something not so different. Since September 11, it is comforting to think that there are people walking among us who have persevered through events far worse than what Americans are likely to face now.

G. DAVID WALLACE

Wallace is an assistant managing editor for technology coverage.



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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

AN OFF-THE-WALL IDEA FOR A NET APPLIANCE



What if you could use the same programs from a Windows desktop on a wireless tablet?

The past year has been cruel to information appliances, those no-frills devices designed to let you browse the Web, read e-mail, and do other simple computer chores without the cost and fuss of a full-featured PC. Many have come and gone, while a couple of models are hanging on with minimal sales. Still, I think there's a lot of life in the concept. And oddly enough, the salvation of the Web appliance could be Windows XP.

This requires some explanation. The curse of devices such as the Compaq iPAQ Home Internet Appliance, or the defunct 3Com Ergo Audrey and Netpliance iOpener, has been lousy software—second-rate browsers and worse e-mail programs. What if you could use the same programs from a Windows desktop on a wireless tablet that weighs two pounds and sits on your lap or hangs on your refrigerator door?

That's where XP comes in. Every copy of XP Pro contains a program called Remote Desktop that lets an authorized person on another computer on a network log on to your PC and work very much as if he or she were sitting at your keyboard, looking at your monitor. This technology, developed by Citrix Systems and formerly known as Windows Terminal Server, has been around for years, but its use was limited by complexity and restrictive licensing terms. Now it's simple and available to everyone.

One of the best things about Remote Desktop is that most of the computing and all the storage is done on the XP machine. The remote terminal doesn't need much processing power. In fact, there's a version of Remote Desktop built into Microsoft's new Pocket PC software, and while the Pocket PC's small display limits its usefulness, the performance is very good. Rebuild a Pocket PC around a big display and a wireless link to a home network, and you have a dynamite tablet that could tap your desktop Windows XP computer. You could read your e-mail from your

easy chair, or call up a Web site with summary statistics while you watch a football game. XP designed to let multiple users work simultaneously, and most current PCs have plenty of power to support them. As an additional benefit, because all the data reside on a single computer, the difficult problem of synchronizing information such as a calendar, on different devices vanishes.

Although this idea came to me while I was using Remote Desktop on a laptop at home to do some work on a computer in my office, it's hardly original. Citrix sells its Independent Computing Architecture to allow remote access to a variety of operating systems from all sorts of devices, including handhelds. Sonicblue recently announced a deal with Citrix that will allow buyers of its Linux-based ProGear tablets

to run Windows applications. The ProGear tablets are sold to such customers as hospitals and schools, typically to run diagnostic applications, such as patient charts.

Microsoft is promoting a different concept for the tablet computer. Microsoft describes the Tablet PC, which says hardware partners will bring to market late next year, as "a fully functional PC running Windows XP Professional.... It is not a companion device, PDA, Webpad." (See www.microsoft.com/windows/xp/tabletpc.) The Microsoft design is basically a laptop turned inside out so that the display is on top, with a touch-sensitive screen and handwriting recognition. Because it has the same components as a laptop, including a keyboard in some cases, its price will likely be "in the medium-to-high-end laptop range," which implies something over \$2,000.

If I want to check out a Web site related to show on television, or if I'm cooking from a recipe, the Microsoft Tablet PC is expensive overkill. And a tablet with those specifications will be lucky to get three to four hours from a battery, not the six to eight that is desirable.

There's still a lot of work to be done to make my off-the-wall idea practical. The most important is that wireless networking, on which the whole concept depends, has to become simple enough so that setting up one or several tablets becomes a true plug-and-play operation.

Interestingly, Microsoft has most of the answers, including a new lightweight operating system called Windows CE .NET that could be perfect for the job. Done right, I think the market that has long eluded Internet appliances is there for the taking. If Microsoft won't seize the opportunity it has created, someone else ought to do it.



▲ MS TABLET PC



▲ SONICBLUE'S PROGEAR

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BY LAURA D'ANDREA TYSON

IT'S TIME TO STEP UP THE GLOBAL WAR ON POVERTY



STRATEGY:
Terrorism
can't be
defeated by
military
means only.
What's
needed are
innovative
ways to
spur
development
abroad

Laura D'Andrea Tyson is dean of the Haas School of Business at the University of California at Berkeley.

Like most Americans, I have been deeply moved by recent images of Afghan citizens celebrating the return of freedom to war-ravaged Kabul—images of people listening to music for the first time in years, of women with uncovered faces walking alone, and of children playing. Such images remind us that human well-being depends on freedom of choice and simple things. Human development, as Nobel laureate Amartya Sen has counseled, is a process of expanding the real freedoms that people enjoy. Successful development requires the removal of major societal sources of “unfreedom” including political tyranny and intolerance. But it also requires the eradication of crushing poverty.

As the war on terrorism has unfolded, Americans have been reminded once more that we live in a world of unprecedented opulence and remarkable deprivation, a world so interconnected that poverty and despair in a remote region can harbor a network of terrorism dedicated to our destruction. In such a world, our prosperity and freedom at home increasingly depend on the successful development of countries like Afghanistan, where income per capita is less than \$1 per day and 20% of the people—10% of the women—are literate.

Winning the war on global poverty won't be easy. It will require a substantial commitment of resources from the developed nations over many years and the creation of new mechanisms to channel support directly to individual citizens, bypassing the inefficient, often corrupt states in which they live. Yet such daunting challenges are not an excuse for inaction. According to World Bank estimates, development assistance must more than double, to about \$100 billion per year, to achieve the U.N. goal of cutting extreme poverty in half by 2015. An increase in assistance on this scale would be enough to eliminate many of the problems at the root of poverty in the developing world—the lack of basic health and nutrition and the lack of basic education required for freedom in the modern world. (As the experience in Afghanistan demonstrates, training in radical madrasahs does not provide such an education.)

GOING TO SCHOOL. Working together, the developed countries can afford the price tag—\$50 billion a year of additional aid amounts to only 0.2% of the gross domestic product of the countries in the Organization for Economy Cooperation & Development (OECD). In real dollars, the U.S. spent nearly \$70 billion on foreign aid in 1949 to help Europe and Japan rebuild after World War II. Today, the U.S. spends less than \$14 billion on foreign aid, about 0.1% of GDP.

Moreover, not all additional development assistance needs to take the form of foreign aid. The U.S. and other wealthy countries can forgive the debt owed to them by developing countries on the condition that they pursue sensible economic policies. Uganda, for example, has used the interest savings on forgiven debt to lower primary school fees, and school attendance has nearly doubled in response. In a recent report on globalization, George Soros identifies another promising approach using special drawing rights, or SDRs. SDRs are issued by the International Monetary Fund and serve as reserve assets that can be used as a means of payment among IMF members, the IMF, and other “prescribed” holders. Soros advocates the creation of new SDRs earmarked for use by development programs to support investment in programs like the spread of literacy and the containment of AIDS.

The developed countries can also support development through further trade liberalization. According to the World Bank, the elimination of barriers to merchandise trade, including trade in agricultural products, could reduce the number of poor in developing countries by 300 million by 2015. At the recent World Trade Organization meetings, the developed countries committed negotiations to curb protectionist measures like antidumping, to reduce agricultural subsidies (currently five times larger than the total foreign assistance of the OECD countries), and to provide cheaper access to drugs to fight disease in developing countries. This agreement is a major victory in the global war against poverty.

What's to prevent additional development assistance from being wasted by repressive, inefficient states? Working together and through multilateral institutions, donor countries should design programs that link assistance to measurable performance indicators like primary school enrollment and literacy rates. In addition, donor governments should forge partnerships with nongovernment organizations with proven track records in delivering food, health, education, and other services to the poor. Micro-lending programs and reproductive health and literacy programs for women also have demonstrated success at promoting development, especially in impoverished rural areas.

In recent days, the U.S.-led multilateral alliance has scored impressive victories in the campaign against terrorism. While celebrating, however, we must not forget the importance of winning the war on global poverty. It is likely to be long and costly, but the benefits to global stability and prosperity are well worth the price.



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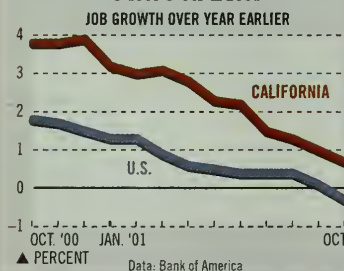
WHERE THE PINCH ISN'T AS PAINFUL

California is outperforming the U.S.

California's economy may have dodged a bullet. Despite an energy crisis, the collapse of tech jobs in Silicon Valley, and the prospect of a big state budget deficit, many economists now believe the state's economy will outperform the U.S. as a whole this year.

The clearest indicator is the labor

CALIFORNIA'S JOB MARKET STAYS AFLOAT



market, where California has seen a much smaller percentage drop in jobs than the country overall. Nonfarm employment for the U.S. peaked in March and has since dropped by 0.7%. It is now below its level of a year ago (chart). By contrast, the number of California jobs continued to rise until June, then fell by only 0.3% and is still up from a year ago. "California has been outperforming and will continue to outperform," says Bank of America economist Lynn Reaser.

Ten years ago, California's defense and aerospace industries were devastated. The end of the cold war halved defense employment in California in the early 1990s, costing more than 137,000 jobs. In contrast, only about 5,000 defense and aerospace jobs have been lost this year. In fact, Northrop Grumman Corp. plans to add more than 1,000 workers over the next year as it ramps up for the new Joint Strike Fighter.

And despite the technology bust, real estate, another weak spot in the early 1990s, also seems to be holding up. The median home price climbed 10% in California in the third quarter, compared with 6% for the nation as a whole. "We're still housing-short," says Stephen Levy, director of the Center for Continuing Study of the California Economy,

a private research group in Palo Alto.

That's not to say the Golden State is worry-free. California also outgrew the rest of the nation in the beginning of the 1990-91 recession but ultimately fell further and stayed down longer than other states. Electricity bills have soared as much as 40% and will stay that way for the foreseeable future. State revenues are shrinking, and the Legislative Analyst's Office estimates that the state could face a budget shortfall of \$12 billion in the fiscal year beginning in July. That will likely mean higher taxes and sharply reduced state spending at precisely the time many experts are calling for higher government expenditures to spur growth. Still, California may endure this recession with less pain than it did the last one.

By Christopher Palmeri

BETTER HEALTH BOOSTS GNP

So federal help isn't just charity

Good health is good for an economy. In fact, a one-year improvement in a country's life expectancy contributes to a 4% increase in its economic output, according to a National Bureau of Economic Research working paper by David E. Bloom and Jaypee Sevilla of Harvard University's School of Public Health and David Canning of Queen's University of Belfast.

Other studies have noted the correlation between a country's health and its output. But it was never clear whether good health was a driving force in increasing output or simply a consequence of such factors as higher income and better education. By analyzing data from 104 countries across three decades, the researchers were able to separate out the impact of better health. They don't deny that higher incomes improve health. But they found that the opposite is also true. Especially in poor countries where manual labor is important, robust people can work harder and make more money. Says Bloom: "Healthier means wealthier."

Government spending on health care is usually seen as an act of kindness. But the paper's authors say that by enhancing economic output, good health may benefit all of society, beyond the benefits to healthier individuals. If so, they say, "increased expenditures on improving health might be justified purely on the grounds of their impact on labor productivity."

GIVE EURO NOTES TIME TO SETTLE IN

The first few months will be rough

Despite cutting interest rates by half a percent, to 3.25%, on Nov. 8, the European Central Bank is still being criticized for not doing enough to fight Europe's economic slowdown. But for the next couple of months, it's going to be difficult to tell whether more interest-rate cuts are really needed.

Why? The introduction of euro notes and coins for ordinary retail transactions, which starts on Jan. 1, will muddy the waters. More than twice as much currency as usual will have to be in circulation to ensure enough euros to get around at the beginning of the changeover. This switch will temporarily swell money-supply figures, push up prices, and distort the financial data the ECB relies on for interest-rate decisions.

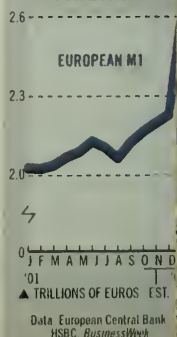
Economists at HSBC Investment Bank in London predict that M1—the narrowest definition of the money supply—will soar by 400 billion euros, 18%, in January alone, after rising only 7% or so over the previous months (chart). Meanwhile, the cost of living could temporarily trend upward as retailers use the conversion process as an excuse to round up prices. "There's a risk you could get a multiplier effect that could fuel inflation," says Robert Prior-Wandesforde, an economist at HSBC.

To complicate matters, distrust of the new money could persuade some investors outside the euro zone to switch marks, francs, and other legal currencies into dollars rather than the euro, which could force down the new currency's value on foreign exchange markets. It all adds up to a lot of uncertainty. "In such an environment, policymakers in Frankfurt might prefer to sit on their hands rather than follow an activist approach to monetary policy," says Prior-Wandesforde.

Things should be back to normal by the end of February, when the changeover is complete. But it could be a bumpy ride until then.

By David Fairlamb

A MONETARY JOLT FOR EUROPE



BY JAMES C. COOPER & KATHLEEN MADIGAN

CONSUMERS CAN'T SHOULDER THE LOAD BY THEMSELVES

A real recovery won't happen until the industrial sector turns around

U.S. ECONOMY

If this is a recession, someone forgot to tell consumers. Coming off of a record 7.1% surge in retail sales in October, they remained in a shopping mood in November, according to early reports on store sales and car buying. Consumer resilience is providing an unexpected boost to the economy this quarter.

At first, the October retail jump might seem like a flash in the pan caused by extremely generous, but temporary, car incentives. And indeed, sales will give back some of those gains in coming months. However, consumers have the means to keep spending into the new year. Lower mortgage rates, falling energy prices, and the tax rebate program have combined to pump billions into household buying power and put household balance sheets in better shape (charts). Plus, rapid progress in the war against terrorism in Afghanistan could help to bolster consumer confidence.

The surprising fortitude of consumers points up a curious conundrum, though: If U.S. shoppers are soldiering on, then why are manufacturers still mired in a recession? Two reasons: First, sources other than current U.S. output, such as existing inventories and imports, are satisfying consumer demand. Second, and more important, manufacturing's top

financial lift from sources besides wages and salaries. Outlays won't come roaring back to the 5% pace of 1999 and early 2000. But real consumer spending is on track to grow at an annual rate of 2% or so in the fourth quarter. That pace may well be healthy enough to offset the contractionary forces of the tech downturn, falling exports, and rising layoffs.

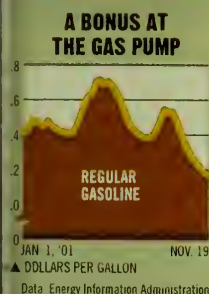
Households are benefiting greatly from this year's interest-rate cuts by the Federal Reserve and from the drop in long-term interest rates. Mortgage rates have dropped from 7.3% at the start of 2001 to about 6.5% now. The volume of mortgage refinancings hit a record in mid-November, says the Mortgage Bankers Assn., and the savings will be significant. Economists at Goldman, Sachs & Co. estimate that refi activity over the next year could free up about \$100 billion in cash.

Household budgets are also getting help from the steep decline in energy prices. Crude oil fell below \$18 per barrel after oil producers were unable to agree on output quotas. If prices stabilize at current levels, *BusinessWeek* estimates that consumers will save nearly \$50 billion between the second quarter of 2001 and the second quarter of 2002 from lower gas prices, with additional savings from cheaper heating oil this winter.

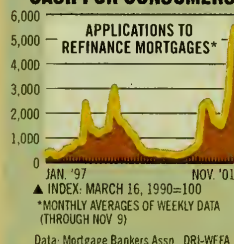
The tax rebate program also improved the consumer outlook, although not because people spent the money, as had been expected. Instead, the bulk of the \$38 billion went into savings and to pay off old debts, two moves that improve balance sheets. Since July, when the rebate program began, installment credit has grown by \$2.6 billion per month, compared with an average of \$9.6 billion in the first half of 2001.

Lastly, low nonenergy inflation and the 20% rally in the stock market since late September will also bolster spending in coming months, even in the face of rising unemployment and continued uncertainty.

UNFORTUNATELY, U.S. MANUFACTURERS haven't been able to take advantage of most of these spending gains. Industrial production fell 1.1% in October; manufacturing output alone was off 1.2%. Production has fallen for 13 months in a row, the longest stretch of de-



REFI MADNESS FREES UP CASH FOR CONSUMERS



problem stems from the collapse of the tech sector.

The tech outlook depends more on a recovery in capital spending than on activity at shopping malls. Holiday sales may beat projections this year, but that won't help the industrial sector whittle away its overvaluing of computers, communications equipment, and other high-tech gear. Despite consumers' grit, the economy cannot mount a true recovery until the industrial sector returns to health, and that will take some time.

CONSUMER RESILIENCE in the face of massive layoffs might seem irrational. Certainly job jitters have undermined confidence, and pay raises are shrinking. Moreover, the jobless rate will continue to rise until the economy can grow at a pace above its long-term trend of about 3% (page 44). Job worries and smaller income gains will temper consumer moods well into 2002. At the same time, however, households are getting a

clines since the Great Depression. In October, the average operating rate for all industry hit 74.8%, the lowest rate in more than 18 years.

One reason why current production has not matched the uptrend in consumer demand is that much of the spending is being satisfied by goods already in inventory. For instance, unit sales of cars and light trucks surged 34% in October, thanks to interest-free financing, but vehicle production fell 4.2%. Almost all of the sales likely came from dealers' stocks. *Ward's Automotive Reports* says that vehicle inventories typically rise 6% or 7% between September and October. This year, stock levels fell 9.4%.

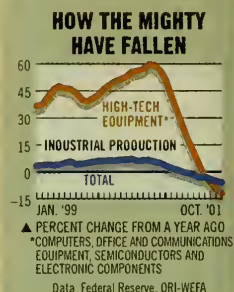
For economic growth, demand satisfied out of inventories is a wash. Inventories shrank in the first three quarters of this year, subtracting just over one percentage point from real gross domestic product growth, and Detroit's experience suggests overall stockpiles are declining again in this quarter. Inventory drawdowns could offset some of the contribution to this quarter's growth coming from the consumer sector.

RIISING IMPORTS are another source of consumer goods. September 11-related insurance claims on overseas insurers narrowed the trade deficit to \$18.7 billion in September from August's \$27.1 billion. Both exports and imports fell in part because of tighter security measures. Even before September, though, imports

were falling, as overall U.S. demand slowed, but the dropoff was less evident in consumer products. Over the past year, total goods imports have fallen 14.1%. Consumer imports were off only 3.7%.

The biggest decline has come in the import of capital machinery, which goes back to manufacturing's No.1 problem: the tech wreck. Past overinvestment in computer gear, the collapse of the dot-com sector, and falling demand overseas triggered the decline of tech output starting late last year. As recently as a year ago, the production of high-tech gear—including computers, communication equipment, peripherals, and semiconductors—was growing at nearly 60% a year. Since October, 2001, output has shrunk 12.5% (chart). Tech equipment makes up only 9% of manufacturing shipments, but it has accounted for a quarter of the drop in factory sales.

Changes in household spending will do little to correct that huge problem. The best the economy can hope for is that solid gains in consumer spending will offset some of the drag from the tech collapse. So far this year, and even after the shock of September 11, consumers have proved willing to carry the burden.



GERMANY

DANGER: RECESSION AHEAD

German Chancellor Gerhard Schröder scored a political victory on Nov. 16, when he narrowly won a confidence vote in the lower house of Parliament over the issue of sending troops to Afghanistan. But with elections coming next autumn, what he could really use is an economic victory, and that's not likely.

Recession is closing in on Germany. Real gross domestic product posted essentially no growth in the third quarter, for the second quarter in a row. The sharp falloff in key September indicators all but guarantees a contraction in GDP in the fourth quarter.

The problems are both at home and abroad. The global slump is

depressing exports and capital spending, as consumers reel from rising unemployment and falling buying power after this year's energy-led surge in inflation.

Consumer spending slowed sharply in the third quarter, and consumer confidence continued to weaken in October. Unemployment last month rose by 27,000 from September, the largest increase in three years.

The industrial sector is especially hard-hit, and business confidence remains at a low ebb. Exports held up for the third quarter as a whole, but they plunged in September, as did industrial production. More important, September manufacturing

orders fell a steep 4.1% from August. For the quarter, bookings dropped at a 10.4% annual rate from the second quarter, a bad sign for fourth-quarter industrial output—and economic growth.

In their annual report on Nov. 14, Germany's official economic advisers, a group of academic economists called the "five wise men," forecast German growth of 0.6% in 2001, including a "slight recession," and 0.7% in 2002. Market economists generally agree with the assessment, although the official government forecast, revised down only three weeks ago, projects 2002 growth of 1.25%.

For now, the war is diverting some attention from the economy's woes. But with joblessness expected to approach 10% next year, the economy will be foremost on voters' minds.





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LIBERATION

The victory over Taliban tyrants is a victory for human

COMMENTARY

By Bruce Nussbaum

The scenes of joy in the streets of Kabul evoke nothing less than the images of Paris liberated from the Nazis. Women taking to the streets to bask in the Afghan sun, free at last to show their faces. Children gathering to fly kites, a once forbidden pastime. Old people dancing to music, banned for many years.

The liberation of Afghanistan from the tyranny of the Taliban is a watershed event that could reverberate for years. The warm embrace by ordinary people of the freedom to do ordinary things is a major victory for Western humanist values. This victory of values, in the long run, may count for far more than the hunt for Osama bin Laden.

This extraordinary turn of events is a reminder to returning

warlords that personal freedoms must be preserved any new government. To the authoritarian governments of the Middle East, it is a reminder that repression—all repression—is hated and resisted. To America, the victory is a reminder that its secular values based on democracy, pluralism, opportunity, and individual liberty are precious not to be taken for granted. Indeed, after a decade in which many of the nation's campuses deprecated the study of Western civilization and embraced multicultural relativism, the liberation of the women and men of Afghanistan makes clear that there is something very basic and profoundly important about human freedom. If this is seen by some as American hegemony, so be it.

The quick crumbling of the unpopular Taliban is made necessary to begin the job of reconstructing the country before bin Laden has been found. But nation-building in a multiethnic society that has never really been a nation



It. It is naive to think that a Western-style democratic system can simply be laid down, but the goal should be the creation of a secular Muslim society that respects religion but does not tolerate fanaticism.

A United Nations-brokered power-sharing conference under way is a good starting point. All ethnic groups from the north and the Pashtuns in the south must be included in any new government. Until it is formed, and perhaps for some time afterward, it would be wise to have a coalition government, which is a NATO member, lead an interim Muslim military force inside Afghanistan. That would prevent the feuding warlords from reverting to their vendettas of the past decades.

When the aid money starts flowing, much of it should be sent directly to the thousands of villages dotting the countryside. Afghanistan is a village-based society, and financing

many thousands of micro-projects at the local level would be the best way to generate growth and jobs. Simply funneling billions of dollars into a handful of huge projects controlled by the central government will guarantee political corruption and may well prove ineffective over time.

Above all, reconstruction must focus on public education in the villages. Every girl and boy must have the opportunity to learn science, math, literature, and history and to get some of the skills to live in a global economy. The Saudi-financed religious schools that bred a generation of anti-American fanatics must be changed in Afghanistan, as well as in Pakistan. It's one thing to teach religion. It's quite another to teach hatred of other religions.

The liberation of Afghanistan is an historic opportunity to open up societies in the Middle East. For decades, the moderate governments of Egypt and Saudi Arabia practiced what can be called the politics of deflection, sustaining their corrupt, undemocratic rule by encouraging the "Arab street" to be vehemently anti-American and anti-Israeli. Newspapers, mosques, and religious schools expressed fierce anti-Christian and anti-Jewish sentiments, which are now widely accepted throughout all strata of Egyptian, Saudi Arabian, and other societies in the region.

After Afghanistan, the politics of deflection are no longer acceptable—to either America or the moderates in the Muslim world. From now on, the battle against terrorism must include the fight for the hearts and minds of the Arab street. The joy expressed by the people in Kabul is a public rejection of the mullahs and their vision of a world based on repression and religious purification. It serves to undermine the message of the Islamic fundamentalists and offers an opportunity to moderate governments to open their political systems to the people.

The end of the politics of deflection also means that Egypt and Saudi Arabia must at last throw their support behind a reasonable accord that trades peace and legitimacy for Israel for land and statehood for Palestinians. By the same token, Jewish fundamentalists in Israel have to learn a similar lesson: They have no divine right to the West Bank.

IRANIAN EXAMPLE. Liberation of Afghanistan may well encourage a cascading effect around the world. Russia is supporting the American war against terrorism in order to lock itself into the Western system. Iran is attempting to do the same thing. Indeed, a generation after the mullahs took over in Iran, its people are demanding the same personal freedoms expressed on the streets of Kabul. American foreign policy in the '90s was narrowly focused on economic globalization and opening markets. Clearly, there's more at stake.

America has been in the throes of a debate over values for some time now. Many people, particularly on college campuses, have been reluctant to champion American values. In fact, the study of Western civilization has been deemphasized at many of the nation's best schools in favor of multiculturalism. It's one thing to understand and respect other cultures. But the battle for Afghanistan changes the nature of the debate. Women are either free or not free. Other religions are either respected or not. A clear polarity of values has been revealed on the streets of Kabul. When extremists take over a culture, we do have a clash of civilizations, and the tolerant one, in the end, is better than the other. That's

what the lesson of Afghanistan teaches us all.

Whether Afghan warlords, Egyptian politicians, Saudi princes, U.N. bureaucrats, and American diplomats now seize the opportunity to spread these values remains an open question. What is unquestionable is that ordinary people want ordinary freedoms wherever they live.

THE NEXT FRONT

AFGHANISTAN

WINNING THE PEACE

What's needed is a mini-Marshall Plan

On the surface, a fragile normalcy has returned to the streets of Kabul. Afghan men are shedding the beards that signaled piety under the Taliban theocracy. Music wafts from long-hidden radios, and crowds flock to a reopened cinema showing a long-banned film. Most symbolic of all are broadcasts of the national TV station, back on the air after a four-year blackout. The inaugural newscast was delivered by a woman—minus the burqa mandated by the Taliban's virtue police.

These scenes of liberation provide a psychological boost to the U.S. and its allies as they wage the war on terror. But while the campaign on the battlefield is going better than many expected, with hard-core Taliban fighters isolated in a few pockets of resistance and terrorist leader Osama bin Laden on the run, the images tell only part of the story.

That's because Afghanistan is an economic and political basket case that will take years, if not decades, to sort out. So the U.S. and its allies will have to remain engaged if they are to translate military victory into a peace that will in turn raise America's standing among the millions in the Islamic world who resent what they deem Western intrusion.

Long before the rebuilding of Afghanistan begins, however, the global community will have to find a way to bring the nation's warring parties together. If history is any guide, that won't be easy. Still, there are signs that the U.S. and its allies, using a mixture of diplomacy and arm-twisting, have at least managed to get the various Afghan factions to agree to sit down in one room. At a conclave to be convened Nov. 26 in Berlin, United Nations rep-

resentatives hope to lay the foundations of a government that would include the plurality Pashtuns from the South and the Tajiks and Uzbeks of the Northern Alliance, which has taken control of Kabul. And to make sure tribal daggers stay sheathed for a while, the U.N. wants Turkey or another Islamic coalition member to deploy troops for a two-year peacekeeping stint, à la Kosovo.

Assuming that a grand tribal conclave can agree on a formula for power-sharing—and that remains a big if—the U.N. can then turn to reconstruction without worrying about aid workers getting caught in a crossfire.

Meantime, the agency will convene the first of many international meetings aimed at assembling a financial coalition to underwrite economic aid. Spearheaded by the U.S. and Japan, and including other wealthy nations, the donor group will consider a mini-Marshall Plan for the cratered Afghan economy.

It's a reconstruction job that could dwarf the current military operation, which costs more than \$25 million a day. One proposal would provide upwards of \$10 billion over 5 to 10 years. But it is a mission Bush Administration planners realize they cannot slough off, even if bin Laden's Al Qaeda organization is shattered. Walking away from the region might cause the country to implode, producing a maelstrom of tribal intrigue, partition—and a breeding ground for a new terror group.

Hence, the U.S. and its allies are girding for the long haul. At a Nov. 20 meeting with representatives of Allied nations and international financial organizations in Washington, Secretary of State Colin L. Powell made clear that this exercise in nation-building will require financial angels to dig deep and dig often. "The international community

**THE NEXT
FRONT
REBUILDING**



DOWNTOWN KABUL *Walking through the ruins*



ruins of the city's commercial district

WHAT MUST BE DONE...

IMMEDIATELY

The U.S. and its allies must ensure delivery of food. They must also ensure the rapid deployment of U.N.-backed peacekeepers from Canada, Europe, and Muslim nations. Resumption of essential services is also critical, including water, sanitation, health care, and minefield-clearing.

MEDIUM-TERM

A massive program must be launched to rebuild roads, bridges, airports, schools, irrigation channels, and wells. Agriculture also needs to be shored up, followed by resumption of opium-substitution programs and a jobs-and-retraining program to help reintegrate some 4 million refugees.

LONGER-TERM

Afghans working with international groups will need to develop a modern financial and judicial system, establish a constitution, hold national elections, and build a national army. They must also encourage foreign investment, including the construction of a long-discussed oil-and-gas pipeline from Central Asia to Arabian Sea.

TOTAL COST:

Over \$10 billion

Data: BusinessWeek

must be prepared to sustain a reconstruction program that will take many years," he said. "This must be a global effort involving East Asia, Europe, the Americas, the Islamic world, and countries in the region."

Moreover, most experts agree that the rebuilding effort cannot stop at Afghanistan's borders. The country sits at the epicenter of one of the world's most volatile regions. Neighboring Uzbekistan, Tajikistan, and Pakistan share many of the ailments afflicting Afghanistan: civil unrest, poverty, and despair—a deadly brew that helped spawn the Taliban. Without jobs, thousands of young men could continue to seek solace from the region's warlords and mullahs. Already, Washington has vowed to provide debt relief, improved market access, and other goodies to Pakistan. And the U.S., Japan, and other rich nations are offering similar incentives to the rest of Central Asia.

HUNGER. The reconstruction effort starts with Afghanistan, a nation reeling from 20 years of war. Even before U.S. bombing began, roads, bridges, and irrigation systems were in ruins. Secular education is virtually nonexistent. The U.N. has been delivering 52,000 tons of food a month since October, but much of the population is still malnourished. According to the World Bank, 7 million are at risk of famine. Some 2 million huddle in Pakistan refugee camps.

The first priority is getting food into the country. Branching out from captured cities such as Mazar-e-Sharif in the north, the U.S. hopes that German, British, and French soldiers can quickly establish bases from which supplies can be doled out. But even that will be tricky in a country that, literally and politically, is best viewed as one big minefield. Many Afghans remain wary of outsiders, mindful of last century's Great Game, in which the major powers routinely redrew the region's borders to create buffer zones. That's one reason the U.S. hopes to keep a low profile and use Islamic peacemaking contingents and international aid groups.

The White House aims to avoid Southeast Asian images of "the ugly American" by following a new model: "the invisible American." A stable Afghanistan "is not going to be achieved by the American military, and it's not even going to be achieved primarily by outsiders," Deputy Defense Secretary Paul D. Wolfowitz said on Nov. 18. "If you're a foreigner, try not to go in. And if you go in, don't stay too long."

Apparently, that suits George W. Bush just fine. The President is com-

mitted to the pursuit of terrorist networks long after Al Qaeda is crushed. Although such an escalating campaign could lead to the doors of Saddam Hussein's Presidential palace, one top adviser to the White House says Bush is eager "to pursue terrorists outside of Afghanistan and let others take the lead in rebuilding" it.

There may be a price to be paid for this detachment, however. An endless series of U.N. donor meetings could slow the crisis response. Rich Gulf states might refuse to pony up without public pressure from the U.S. And, of course, corruption, a fact of life in Afghanistan, could become an even worse problem if money suddenly showers down on village elders. "If you [just] pump money in, a lot of it ends up where you don't want it to go," says Stephen F. Rasmussen, general manager of the Aga Khan Rural Support Program in Islamabad. "It takes a long-term commitment to rebuild a society."

NATIVE TALENT. For the moment, the U.N. is upbeat. "The pool of Afghans we can deploy to begin to move things forward is enormous," says Mark Malloch Brown, administrator for the U.N. Development Programme (UNDP), which hopes to entice highly skilled exiles back to the country. "Foreigners will be playing a more subdued role."

The model: a greatly expanded version of the five-year, \$6.5 billion U.N. program to aid Mozambique. The project is credited with helping that country recover from a brutal civil war. Afghanistan, with a far bigger pool of doctors, lawyers, and teachers to potentially draw on, seems like a good bet for a reprise. To limit aid ripoffs, the World Bank plans to set up a trust fund to oversee Afghan disbursements.

Still, when the U.N. gets its act together on a donor coalition and starts turning aid chits into real money, relief

workers will face a mind-boggling job. Mainly agrarian Afghanistan's gross domestic product has languished at about \$2 billion for years, while per capita income, at less than \$80 a head, has steadily fallen.

That's a stark contrast with the Afghanistan of 1979. While still poor, back then, the country had verdant orchards and vineyards in the Kandahar plain, plantings that accounted for 35% of export earnings. Indeed, Afghan grapes and melons are still considered the finest in South Asia. Kabul was once a bustling city of wide, tree-lined boulevards. Women comprised 70% of the nation's teachers, and female students accounted for 50% of the enrollment of Kabul University, where they studied side by side with males.

Today, the nation is in ruins, and the professionals needed to staff reopened ministries of education, transportation, and health have mostly fled. One hope is that the return of exiled King Mohammed Zahir Shah will lure them back.

The U.N. will focus first on critical infrastructure. According to the UNDP, an interim program of public-works spending alone would run in excess of \$650 million and then mushroom to far more. Kamal Matinuddin, former director of the Islamabad Institute of Strategic Studies, reckons it could ultimately cost as much as \$10 billion just to rebuild roads and bridges.

The U.N. is also expected to resume an alternative-crop program designed to persuade Afghan farmers to restore ruined agricultural plots—and to grow



KHANABAD Burqa-clad women pass a

wheat rather than opium poppies. The Taliban intermittently banned poppy cultivation, but with regional warlords swaggering around the countryside again, large-scale planting could resume soon. Even before U.S. bombs began falling on Afghanistan, the UNDP was working with farmers to improve agricultural productivity. And that kind

VITAL SIGNS

Afghanistan's Failing Economy

POPULATION

21 million

SIZE OF ECONOMY

About \$2 billion

INTERNALLY DISPLACED PEOPLE

1.2 million

PER CAPITA GDP

\$80 (down from \$200 in 1979)

ILLITERACY RATE

80%

SCHOOL ENROLLMENT

39% of boys;
3% of girls

MAJOR NONFARM ECONOMIC ACTIVITY:

Goods-smuggling,
drug-trafficking

MALNOURISHMENT RATE

70%

LIFE EXPECTANCY

40 years

Data:

World Food Program,
UNDP, BusinessWeek



DONATED WHEAT A dock worker loads a barge



ern Alliance tank and soldiers as they flee U.S. bombing on Nov. 18

■ In 1979,
Afghanistan had
verdant orchards
and vineyards
that accounted
for 35% of export
earnings

was to co-host a meeting of 35 nations to discuss long-term aid for Afghanistan. Britain and France are expected to make major new commitments as well.

To the White House, assembling a mega-aid package is the surest way to win over Afghan warlords. "We will use that postwar aid as leverage to ensure that a coalition government is formed that meets our expectations," says a Bush adviser. "One reason we got into trouble here in the first place was our laissez-faire attitude toward the *mu-jahideen*" after Russia's Afghan invasion.

To some Central Asia hands, though, the Administration's game plan—while sober, subtle, and financially ambitious—still represents a monumental commitment for a coalition that may lose momentum if Osama bin Laden is laid low and the military campaign moves on. In that case, "attention may switch to other parts of the world," frets Paula R. Newberg, former special U.N. adviser on Afghanistan. While the Allies are vowing to rebuild the nation's shattered economy, she adds, "recent history suggests that has never been a high priority."

Newberg has a point. But it's also true that the world has seldom seen the kind of concerted international action that the U.S. has mustered to combat the terrorist threat. What remains to be seen is whether all that energy will translate into the kind of sustained aid that would put Afghanistan back on its feet—and boost Washington's credibility in a largely hostile world.

By Lee Walczak and Stan Crock in Washington and Frederik Balfour in Islamabad, with bureau reports

ork will need to be expanded manyfold once the situation is stabilized. "A lot of the social glue is at the village level," notes a World Bank official. By targeting the grass roots, "you can achieve a lot."

Afghanistan's schools pose another headache. Apart from a few run covertly, only *madrasahs*, or religious academies, have flourished. Many schools have been shuttered or turned into arms depots. As a result, the illiteracy rate is now 80%. That grim statistic, plus the main drain of professional elites, has left a populace more willing than able to lift itself by its bootstraps. "You have a whole generation [that's] not educated," comments Knut Ostby, the UNDP's senior deputy representative to Afghanistan. "It's going to take almost a whole generation [to restore society] again."

With the shape of a post-Taliban regime murky, few Afghans in Pakistan are ready to rush home. Consider Zaharaba, a 27-year-old women's-rights activist who left Jalalabad 20 years ago with her family. She claims former Pres-

ident Burhanuddin Rabbani, who is back in Kabul angling for influence, has a track record of repressing women that is scarcely better than the Taliban's. "Now, there are a few women on TV," she says. "But this isn't the reality."

Members of the anti-terror coalition realize that Afghanistan's list of woes seems as endless as the nation's tribal intrigue. But they're determined to give reconstruction a go—if only to show that there are tangible rewards to be earned in resisting terrorists. Still, the U.N. has a ways to go to turn the Allies' clucks of concern into hard cash. In October, the agency sought \$664 million for a six-month Afghan-relief effort. To date, only \$279 million has been received.

Although the drive for financial support grinds slowly, headway is being made. Japan has pledged \$37 million in food aid for refugees and just announced that it will extend an additional \$300 million over two years to help coalition partner Pakistan with health and education needs. In late November, Japan

COMMENTARY

By Stanley Reed

MODERATES MUST SEIZE THE MOMENT FOR REFORM

Time and again, wars have reconfigured the landscape and character of the turbulent Middle East. America's smashing of the oppressive and backward Taliban regime in Afghanistan, which has the peoples of the region riveted to their television sets, is also likely to have a huge impact. Even their favorite news channel, Qatar-based Al-Jazeera, has had its share of drama. The station's uplink in Kabul was hit by a U.S. missile as the city fell. Since then, Al-Jazeera has largely pulled out of Afghanistan and been forced to rely on feeds from CNN. That has changed its mix of coverage from heartrending coverage of children being pulled from rubble to more straightforward political and military footage.

The Taliban's rapid collapse undoubtedly comes as a shock to many Al-Jazeera watchers and others in the region who expected a more resolute stand. Moderate Arab governments are reacting mostly with relief. A quick end to the war eases pressure on leaders fearful of a popular backlash to the campaign against a fellow Muslim, Osama bin Laden; ultimately, it may also weaken the appeal of the fundamentalist vision he and the Taliban have offered. But outside the corridors of power, criticism of the U.S. continues—and few are celebrating the U.S.-led campaign for its liberation of the Afghan people. "The Americans did not bomb Afghanistan so men could shave their beards and women would not have to hide their faces," says Fahmy Howeyda, a columnist for the government-owned daily, *Al-Ahram*, in Cairo. "It's been more than 40 days and they've kept bombing the Afghani people. This will violate the image of the U.S. in the Arab world."



IN CAIRO Arab media left many unprepared for the sudden rout

Yet when the bombing ends and the money starts flowing to Afghanistan, the U.S. hopes such sentiments will change. There's an opportunity here for Arab regimes, their people, and the U.S. to further the cause of moderation and ease the tensions that have long plagued the Arab world. The U.S. can play its part by rebuilding Afghanistan, pushing for Mideast peace, and urging Arab governments to open their political and educational systems. Arab rulers can use this moment to reconsider how to open their economies and give their people a voice. And the Arab peoples can help by giving moderation a chance to show results.

The crisis has certainly exposed the shortcomings of the Arab regimes. Their economies, which are mostly holdovers from the heyday of Third World socialism, have performed disastrously in recent years. The absence of job opportunities, combined with a lack of outlets for political dissent, provides a rich medium for nurturing the reli-

gious extremism endemic in the region. Their repressive political systems need light and air.

The time has come for moderate Arab governments to look into the mirror. The leadership of Egypt, Saudi Arabia, and Kuwait must grasp the

of refusing to change. Continued repression and stagnating economies will only further the cause of fundamentalism who could eventually threaten their regimes. That would be to already-strained relations

with the U.S. Because Saudi Arabia produced so many of the terrorists who attacked America, the desert kingdom faces mounting criticism in the West for its retrograde system. If the kingdom is implicated in some future incident, it could encounter the wrath of the Congress or even a U.S. raid to capture suspected terrorists.

Certainly, some in the Arab world recognize these dangers. In Kuwait, Nasser bin Fahd al-Sabah, the leader of its liberal National Democratic Front, is now calling for sweeping reforms to restore

THE NEXT FRONT
THE MUSLIM REACTION

ged image" of Islam. He wants to separate religion from the affairs of the state, arguing that is the only route to a peaceful society. In Egypt, young business executives, including President Hosni Mubarak's son Gamal, are pushing to open the economy to outside investment. In Saudi Arabia, too, Crown Prince Abdullah is trying to stamp out corruption, and King Abdullah also shows signs of curbing the military establishment, which has too much power in recent years. On Nov. 14, he warned Saudi clerics in a sermon that they should tone down their rhetoric. "I hope you appreciate your responsibility before God so we do not land in a embarrassing situation," he said.

FERMENT. The U.S. should throw its weight behind any reform efforts by Mubarak and other figures. There is much at stake for the West—and not just because the Middle East has 65% of the world's oil reserves. Most of the countries in the region have youthful, fast-growing populations. If governments fail to satisfy their citizens' needs, social ferment is likely to rise. A major danger is that young Middle Easterners increasingly view the U.S. as the enemy. Arabs and Muslims—not only beneficiaries of its attacks on the Taliban but also of its strong support of Israel. The Bush Administration could ease tensions through its new push for cooperation between the Palestinians and Israel. In a speech on Nov. 19, U.S. Secretary of State Colin L. Powell warned the Palestinian leadership that it "must end the violence, stop incitement, and prepare [the Palestinians] for the hard compromises that will be required." But he also told Israel it "must be prepared to end its occupation" and "accept a Palestinian state."

The peace drive in the Middle East involves five moderate Arab states more open to domestic reform and for cooperation with the U.S. on regional security matters. It could also lay the groundwork for closer cooperation between the Arab states to rid the region of bad characters. Everyone agrees that countries such as Iraq, Syria, and Iran have harbored terrorists in the past. Up to now, radical Palestinian groups and other violent groups have been able to portray themselves as war-torn liberators. If tension on the Israeli front were reduced, they would lose their cover. The September 11 attacks and the war in Afghanistan have made terrible events, but they give the Arab world a chance for a new start. That chance should not be lost.

With Susan Postlewaite in Cairo

GOING AFTER SADDAM: WHY IT'S A WAITING GAME

White House advisers are divided on how to deal with him

With the war in Afghanistan heading for a denouement, strategists inside and outside the White House are turning their attention to another hotbed of terrorism: Iraq. It's no secret President Bush has long been hostile to Saddam Hussein's regime, which has bankrolled terrorism in the Mideast, pursued weapons of mass destruction, and, a decade ago, survived his battle with the first Bush Administration.

Still, there's much disagreement within the Administration over the way to deal with Iraq. Hard-liners such as

Deputy Defense Secretary Paul D. Wolfowitz, backed by the GOP right wing and Israeli sympathizers, advocate going after Iraq. But other foreign-policy heavyweights, such as Secretary of State Colin L. Powell, fear an attack would split the anti-terror coalition. So while Bush has many choices if he decides to take on Saddam—ranging from calling in a huge ground force of American GIs to further isolating Iraq with sanctions the

Administration pushed in the U.N. earlier in the year—no decisions have been made. Here's a look at the options:

■ **Desert Storm II.** Launching a major offensive could topple Saddam. But without hard evidence that Iraq was involved in the September 11 attacks or other recent terrorist acts, there will be no support in the region or among U.S. allies for the campaign. A lack of diplomatic backing would have military consequences. Without access to bases in Saudi Arabia or Kuwait, a U.S. ground invasion is all but impossible. And neither country is willing to stand alone in the Arab world on America's side.

■ **Afghanistan II.** The U.S. could try to destabilize Iraq by providing air support and covert assistance to indigenous fighters—exactly the same strategy used so successfully in Afghanistan. But Iraq isn't Afghanistan. For starters, the Iraqi

Republican Guard is better trained and better equipped than the Taliban were, and would no doubt prove far tougher and more determined. What's more, opposition groups such as the London-based Iraqi National Congress are weaker than the war-hardened Northern Alliance, which had years of experience fighting the Taliban.

■ **Smart Sanctions II.** The Bush team could revert to its earlier U.N. proposal of punishing the Iraqi regime while cushioning the blow to the overall Iraqi population. The focus of import restrictions

would be on items that could be used to produce nuclear and chemical weapons while easing restrictions on civilian goods. And neighboring countries would crack down on oil smuggling, which bankrolls Saddam's weapons development. Russia had thwarted the previous Bush-backed U.N. sanctions but might have a different view now that President Vladimir V. Putin has cast his lot so unreservedly with

Washington. Other nations that had balked in the past may also be more amenable in the wake of September 11, particularly if direct evidence linking the Iraqis with Al Qaeda piles up.

One way or another, the rout of the Taliban in Afghanistan isn't good news for the Iraqi regime. At the very least, it gives the U.S. a chance to "make sure we get some concessions from the world to contain Saddam Hussein," says Kenneth M. Pollack, deputy director for national security studies at the Council on Foreign Relations and a senior foreign policy adviser in the Clinton Administration. That may mean Saddam will be safe a while longer. But if his development of dangerous weapons is curbed, the rest of the world will be safer, too.

By Stan Crock and Richard S. Dunham in Washington



HUSSEIN *Finish the job?*



ARRESTS IN SPAIN A judge says eight men "were directly involved in the September 11 attacks"

THE INVESTIGATION

NOW, 'A DIFFERENT KIND OF WAR'

Pursuing Al Qaeda in 50 countries means global teamwork

As Taliban forces cling to an ever-shrinking corner of southern Afghanistan, the second front in the war against terrorism—the pursuit of the Al Qaeda network in as many as 50 countries—is fast growing in importance. This is the "different kind of war" the Bush Administration has been talking about since September, a submerged conflict of smoke, mirrors, and clandestine operations—and it could take years to prosecute fully. It could also call for whole new levels of activity. U.S. Defense Secretary Donald H. Rumsfeld, for example, now wants to assign FBI agents to work directly

with top U.S. military brass around the globe, all to speed up the hunt for terrorists and their allies.

In this war, it seems, the distinctions between civilian and soldier are dissolving rapidly. The trouble with the conflict is that it will never be completely clear when it is time to declare victory. Some estimates of the Al Qaeda membership outside Afghanistan run to 15,000, and it is impossible to identify all the affiliates at work. "The big worry is that you have one or two other cells planning big attacks. They can involve a year or more of planning and waiting,"

says Alain Grignard, a Belgian police specialist on Islamic terrorist networks. One top Italian prosecutor says many Al Qaeda associates flew to Afghanistan after September 11 to regroup and get new assignments. France and Britain could be the next targets, according to investigators.

Yet thanks to an unprecedented manhunt mounted by police agencies from dozens of countries, at least the contours of Al Qaeda's global web are starting to come to light. The gains are hard won. In the U.S., law-enforcement agencies now have some 1,100 suspects in custody, and the Justice Dept. has compiled a list of 5,000 it wants to interview, though few charges have been filed. A lot of the focus is now on Moroccan-born Zacarias Moussaoui, who

THE NEXT FRONT TERRORISM

sought flight training in the U.S. He may be part of a group that planned a follow-up attack in Europe after September 11, but he has not been charged.

The Europeans may soon have more to show for their efforts than their American counterparts. On Nov. 18, Spanish police charged eight suspects with accessory to murder for involvement in the

attacks on the World Trade Center and membership in Al Qaeda. National Court judge Balthazar Garzón says evidence including taped phone conversations and links to lead hijacker Muhammad Atta how the eight "were directly involved" in the September 11 attacks. All eight reclaim their innocence.

In Germany, meanwhile, no fewer than 600 agents of the Federal Criminal Agency have been investigating Al Qaeda operations. Police have pieced together the complex puzzle of how September 11 hijackers Muhammad Atta, Imad Jarrah, and Marwan Al-Shehri planned the New York and Washington attacks from a nondescript apartment in Hamburg.

WEAK LINK. More information may come out of other trials. On Dec. 20, Italian prosecutors will begin trying eight suspected members of a North African movement, the Salafist Group for Preaching & Combat, which has been affiliated with Al Qaeda and is charged with planning a cyanide-gas attack in France. The trial could shed light on vital links between Al Qaeda and North African terrorist groups, which have been trained and encouraged by bin Laden to expand throughout Europe. While sentences for trafficking in arms and dangerous chemicals are relatively light, Italy is preparing a law with stiffer penalties for international terrorists.

Britain may start generating more leads as well. Traditionally, it had an open-door policy for political refugees from around the Middle East and a laissez-faire attitude toward them once they settled. That is a marked contrast to France, which has tightly watched over its 7.5 million-strong Muslim community—to the point of having agents of its internal security service convert to Islam so as to penetrate Muslim groups. In Britain, thousands of Islamic radicals sought refuge, including people such as Jordanian cleric Abu Qatada, who is thought to be an Al Qaeda operative. He denies this. Now, British intelligence services have drawn up a list of 20 top Islamic militants, including Qatada, to be arrested as soon as a controversial anti-terrorism bill becomes law, most likely by the end of December. The bill will allow internment without trial.

■ British intelligence has drawn up a list of 20 top Islamic militants to be arrested as soon as a controversial anti-terrorism bill becomes law

If U.S. and allied military operations in Afghanistan culminate in a clear victory, these law-enforcement efforts will get a big boost. For the first time, Al Qaeda may have nowhere to take refuge. Bin Laden and his top lieutenants have been chased out of Saudi Arabia and Sudan. Taliban-ruled Afghanistan was their last redoubt. Ten or 20 years ago, many countries—Syria, Iran, Sudan, and North Korea, just to cite a few examples—looked the other way as terrorist groups set up shop in their nations. East German security services even aided notorious terrorist networks such as the Red Army

Mediterranean Studies in Lugano, Switzerland.

A crucial factor in the war against terrorism will be the extent of cooperation among Western police forces. Traditionally, cross-border consultation among police forces has been abysmal. That is changing. Within two weeks of the September 11 attacks, European leaders proposed legislation on a common European arrest warrant. And banking authorities in normally guarded Switzerland, Liechtenstein, and Austria have been opening their books. These developments, says Spanish terrorism expert and member of Parliament Gustavo Aristegui, "were unthinkable a year ago."

One big question mark is transatlantic intelligence-sharing. There are complaints from Europeans that Washington takes information but rarely offers it. Robert Rotberg, a terrorism expert at Harvard University's John F. Kennedy School of Government, says the U.S. will have to adjust. "It means finding ways of sharing info at a level we haven't done," says Rotberg. "There are people in the CIA and Pentagon who would be leery of that—and with reason. But it still has to be done."

LONE OPERATOR. All the cooperation in the world won't snuff out the terror threat entirely. If Al Qaeda is broken, the spectacular attacks that only years of elaborate planning can produce could well end. But isolated, less dramatic acts of violence could occur, driven by lone operators whose actions may be much harder to detect and prevent.

This war is not going to be won by B52s, Delta Force, and spy satellites. It is going to require huge amounts of intelligence-sharing, legal reforms, and targeting of financial networks, to say nothing of diplomatic efforts to keep wavering countries in the anti-terror coalition. Afghanistan is only the beginning.

By John Rossant in Paris, with Kerry Capell in London, Jack Ewing in Frankfurt, Gail Edmondson in Rome, and Paul Magnuson in Washington

ON THE RUN

As the Taliban collapses and the hunt for bin Laden narrows, the crackdown on terrorism intensifies:

U.S. Few charges filed. More than 1,000 suspects are in custody, and the Justice Dept. seeks to conduct 5,000 interviews. FBI, Pentagon, and Treasury are working more closely to coordinate efforts.

FRANCE More than 30 suspects with alleged links to al Qaeda detained; intense surveillance of Islamic groups. Vast toughening of police powers in legislation passed in November.

GERMANY 6,000 tips lead to investigations of 448 people. Government suspects a dozen people may have been involved in the September 11 attacks. Anti-terrorist legislation to be strengthened.

SPAIN Imad Eddin Barakat Yarkas is one of eight suspected Islamic operatives charged with accessory to murder in the September 11 attacks.

ITALY Forty-nine suspects under interrogation, eight suspected Islamic terrorists jailed, and 20 suspect bank accounts frozen. An anti-terrorist swat team of 600 agents was created in October, and legislation providing new penalties for terrorism is in the works.



YARKAS

Faction. "The fact that no state will now be there to give [terrorists] territory for their camps, to sponsor them, is a very big difference," says Roland Jacquard, head of the Paris-based International Observatory for the Study of Terrorism. And even "sleepers" need direction. "If bin Laden and others are killed, the Al Qaeda cells would lose their most important reference and would be immensely weakened," says Antonella Caruso, a specialist on Islamic movements at the Center for



PUMP IT UP
A deep price war would damage Russia's economy

of the Saudis' total export revenue come from oil, compared with just 25% for Russia. Oil exports sustain every important government project, from the building of hospitals to the laying of roads. And despite its oil wealth, Saudi Arabia has a 15% unemployment rate and a rapidly growing workforce. If oil drops to \$10 a barrel, the economy could slip into a destabilizing recession. Some in Russia are betting that the prospect of political unrest will push the Saudis to give in first on production cuts.

Perhaps. But the Russian oil industry, now in private hands and notorious for its internecine warfare, is hardly speaking with one voice. Sounding the bugle for an all-out battle with OPEC is Russia's second-largest producer, Yukos, which this year has increased production by nearly 18%. Yukos argues that the dispute offers a golden opportunity to grab share and establish Russia as a safe and reliable alternative to OPEC.

But No. 1 producer Lukoil says Russia should try to reach a compromise with OPEC. It makes no sense to attempt to grab market share by a production hike, says Lukoil Vice-President Leonid Fedun, because Saudi Arabia can more cheaply match any such increases. "I don't think for the success of one company, all the other Russian companies and the Russian budget should pay," says Fedun. But in fact, Lukoil does not have the rest of Russia on its side. Sibneft, Russia's sixth-largest oil producer, is vowing to stick with plans to increase its output by 18% in 2002.

Ultimately, it will be up to Putin to determine Russia's position. The Kremlin can't order companies to slash output. Nevertheless, Putin is enormously popular and controls tax policy and other instruments of importance to the oil industry. So Russian producers, including Yukos, agree that it would take but one word from the President to persuade them to fall in line. With his bid for closer ties with the West, Putin might be tempted to go along with Yukos. But if oil prices continue the precipitous fall, economic pressures at home may force him to rethink the virtues of trying to please everyone.

By Paul Starobin in Moscow

PETROLEUM

AN OPPORTUNITY FOR RUSSIAN OIL?

Some producers want Putin to square off with OPEC

In one corner: Saudi Arabia, the world's top oil producer and leader of OPEC. In the other: ever-combative Russia, the No. 2 producer. With Russia refusing to heed recent OPEC demands to join in big production cuts, the sparring could escalate into an all-out price war. Lower oil prices could aid consuming nations, including the U.S., but damage the economies of the producers. The prime question in this test of nerves: Who will blink first?

Right now it's a hard stare on both sides. With 61% of the world export market, OPEC members at their Nov. 14 meeting in Vienna declared a willingness to slash production by 1.5 million barrels a day to get the price of OPEC's market basket of crude back up to \$22 to \$28 per barrel. That price, as high as \$34 a barrel 14 months ago, fell below \$16 before rebounding slightly on Nov. 20. But if producers don't come to terms, prices could go as low as \$10 a barrel.

To protect its market share, however, OPEC said it will implement the cut only if Russia and other non-OPEC countries

cut output by 500,000 barrels a day. Russia's response was an offer by Prime Minister Mikhail Kasyanov to trim production by 30,000 barrels a day. In other words, *nyet*. The insult hit its mark. "Russia's cut is minuscule and disappointing, and we don't take it seriously," says Saudi Oil Minister Ali Naimi, whose country has cut output by over 2.5 million barrels a day. Other big, non-OPEC producers such as Norway and Mexico have agreed to make production cuts. But Russia is sticking to its position.

Both Russia and Saudi Arabia have plenty to lose if prices spiral down. Rising oil prices have been the leading contributor to Russia's rebound after its August, 1998, financial crisis. Russia's domestic debt is only 2% of gross domestic product, vs. 18% before the crisis. Nevertheless, every \$1 drop in the price of crude costs Russia about 0.3% in GDP, \$2 billion in export revenues, and \$1 billion in federal revenues.

"DISASTER." The country could tolerate oil prices of \$15 a barrel. At that level, however, annual GDP growth, pumped up to 5.5% by high oil prices for most of the year, would drop to 1.6%, according to an analysis by Moscow-based Alfa Bank. "Ten dollars per barrel would be a major disaster for Russia," says Steven Dashevsky, an oil analyst at Capital Group Aton in Moscow.

Saudi Arabia, which has much cheaper production costs, would seem better positioned. But its overall economy is much more dependent on oil. Over 90%

RANKING	OUTPUT	EXPORTS	PRODUCTION COSTS*	OIL AS % OF TOTAL EXPORTS
 THE OIL GIANTS	Saudi Arabia: 8.2 million barrels per day	Saudi Arabia: 7.6 million barrels per day	Saudi Arabia: \$5.40 per barrel	Saudi Arabia: 90 to 95%
	Russia: 7 million barrels per day	Russia: 4.7 million barrels per day	Russia:** \$10.30 per barrel	Russia: 25%

*Includes cost of finding replacements
**And other former Soviet republics
Data: U.S. Energy Information Administration

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CROWDED: At an employment fair in New York City

with a 5.8% unemployment rate already."

There are troubling signs that this recession, like the 1990-91 downturn, will be followed by a so-called jobless recovery. The slowdown ended in March, 1991, but high productivity meant that unemployment kept climbing for 15 more months, peaking at 7.8% in June, 1992.

The latest labor market reports show a sharp increase in the number of people who have lost jobs and haven't found new ones. In October, those job losers hit 3.1% of the workforce. Such long-term job loss is what forces people to cut back spending. Only when job losers hit 3% in October, 1990, for example, did consumption finally be-

gin to shrink. "With the high percentage of job losers, we will see a plunge in consumption," says Srinivas Thiruvadanthai, an economist at the Jerome Levy Forecasting Center in Mount Kisco, N. Y.

WAGE CURBS. Another bit of bad news for spending: Unemployment seems to be getting high enough to hold down wage growth. Richard Berner, chief U.S. economist at Morgan Stanley Dean Witter & Co. estimates that in the three months ending in October, wages and salaries, adjusted for taxes, shrank at 1.5% annual rate.

Falling wages and rising unemployment could start to undermine the housing market. The housing affordability index published by the National Association of Realtors shows a drop in the third quarter, despite lower interest rates. "Unemployment is often a good predictor of the housing market," observes Susan M. Wachter, a professor at the University of Pennsylvania Wharton School.

One big question now for the labor market is whether the decline in technology spending will make it harder for companies to keep boosting output with fewer workers. But there are signs that the technology sector may be bottoming out. Tech production declined by only 0.7% in October, less than half the rate of the previous four months.

In the long run, higher productivity growth is clearly beneficial. But in the short run, it may mean that labor markets will take longer to recover than many Americans would want.

By Margaret Popper in New York

THE ECONOMY

A 'JOBLESS RECOVERY' JUST AHEAD?

Why unemployment may keep rising even after growth picks up

So far, massive job cuts by U.S. companies have not stopped consumers from spending. Despite a big jump in unemployment to 5.4% in October, low interest rates have kept car and home demand high and boosted retail sales.

But consumers will likely face a tougher slog in the months ahead. Rising corporate productivity is making it possible for businesses to maintain or boost output with fewer employees. That means companies will likely keep shedding workers well into next year, even if the economy starts growing again.

Indeed, many economists believe unemployment could hit 6.5% or so by June—a level that will hurt many experienced workers, reduce wage gains, and slam wallets shut. "Over the next few months, we are likely to start seeing a

more traditional reaction to rising unemployment—a drop in consumer spending," says Lawrence F. Katz, a professor of economics at Harvard University.

The arithmetic is simple. Just to keep the unemployment rate where it is now, the economy has to grow fast enough to

absorb the workers made expendable by rising productivity, plus any new entrants into the workforce. The U.S. labor force grows at a rate of about 1% annually. Most economists believe that the annual trend rate of productivity growth is now around 2%. So even after the recession ends, the jobless rolls could keep expanding as long as growth is below 3%—a

rate few forecasters expect to see soon. "We're still on the up slope," says Ethan Harris, chief economist at Lehman Brothers Inc. "Continuing claims [of unemployment insurance] are consistent



By Louis Lavelle

THINKING BEYOND THE ONE-SIZE-FITS-ALL PAY CUT

Three decades ago, General Electric Co. nearly made a half-trillion dollar mistake. A young Jack Welch, having spent a year working overtime to distinguish himself from the pack, was handed the "standard" \$1,000 raise. As Welch tells it, in *Jack: Straight from the Gut*, he was on the verge of quitting—a move that would have deprived future shareholders of billions of dollars in wealth. It wasn't until an executive slapped an additional two grand on the table that Welch decided to stay. "In bad economic times, you have to take care of your best," Welch said recently. "Go hug your best. Give them a raise while you're laying other people off."

GE no longer uses "standard" raises, but many other companies do. Now, as the economy weakens, a new trend has emerged: standard pay cuts, pay freezes, and reduced bonuses. Agilent Technologies, Tribune Co., and DiamondCluster International have all used this approach. Undoubtedly, they believe it's more egalitarian than cutting jobs.

STARK DIFFERENCES. But if layoffs are the unkindest cut, across-the-board pay reductions may be the most foolish. Treat the company stars the same as the laggards, and you risk losing your future Jack Welch. Instead, employers need to do the hard work of truly differentiating among their staff members. That means giving performance reviews with teeth and making it clear to one and all who's at the top of the heap as well as who's at the bottom. Most of all, it means giving your best people—the ones you'll need for the rebuilding effort when the economy bounces back—much, much more. To do that, some people (let's call them the deadwood) will have to make do with smaller raises, or none at all. "Never be afraid to overpay your overperformers and underpay

your worst performers," says Buck Consultants' Randy Ramirez.

The results can be dramatic. Towers Perrin recently surveyed 721 North American companies and found that the most successful all had one thing in common: They were nearly three times as likely to give their best employees massive raises. Of

to weed out laggards. Says Fuersich: "All companies have their back to the wall right now. It's survival mode. In survival mode, you keep the people who are going to keep you healthy."

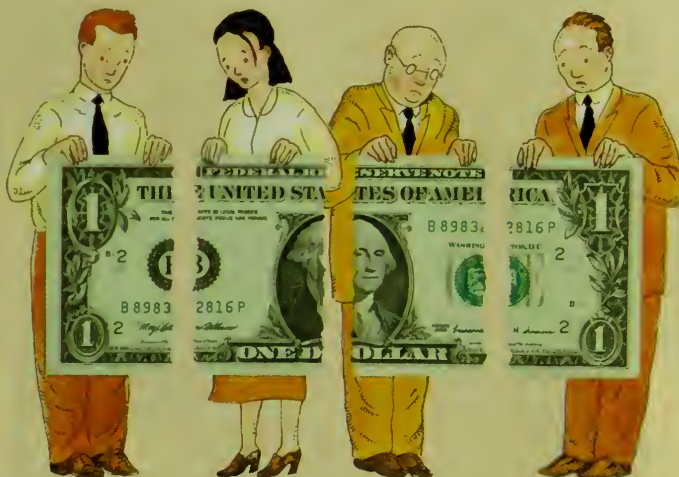
Some companies have already learned that lesson. At Electronic Data Systems Corp., in any year, less than 40% of employees get a bonus, and only 75% get raises. At Wal-Mart Stores Inc., bonuses paid to store employees are based solely on the performance of their store. And at Gateway Inc., some employees may get 15% raises next year, while others may get nothing. Says Jack Van Berkel, senior-vice president for human resources: "If you get 15%, you're a star. And everybody is going to know that you're a star."

To be sure, companies that trim payroll costs through across-

the-board pay cuts or freezes think they're doing the right thing. Melvyn E. Bergstein, CEO of DiamondCluster International Inc., a Chicago consultant, cut cash compensation for partners 15% in an attempt to remain cash-flow neutral without layoffs. It didn't work: he ended up cutting 10% of his workforce. CEO Edward W. Barnholt of Agilent Technologies Inc., faced with weakened demand and canceled orders, cut pay 10% in May as a matter of survival: "We just couldn't keep burning cash forever and stay in business."

That's the problem. Too many CEOs view salaries and bonuses as fuel for the corporate furnace when they should be looking at them as a tool to shape a better workforce, and more important, build a deeper bench of future leaders. Pay everyone the same—in effect telling your top performers they're no more valuable than the deadwood—and your best people will bolt. Treat them like the stars they are, and you'll win their loyalty forever. It's a Darwinian approach, but it works.

With Michelle Conlin in New York



course, leaving unproductive people out in the cold could result in many of them moving on. But as long as they're the bottom 10%, why worry? It's probably the right move for them as well as the company. Janet Fuersich, rewards-management principal at Towers Perrin, says the best companies viewed turnover as a chance

NIP AND TUCK

For employers trimming costs, axing workers is just one method

	% TAKING ACTION*	% CONSIDERING ACTION
LAYOFFS	50%	38%
DELAYING NEW-HIRE START DATES	18	25
REDUCING PERKS	13	14
SALARY FREEZES	9	20
REVOKING JOB OFFERS	9	6
FREEZING PROMOTIONS	8	11
UNPAID VACATIONS	4	7

*From a survey of over 100 companies in August, 2001

Data: William M. Mercer Inc.

MANAGEMENT

THE REAL CONFESSIONS OF TOM PETERS

Did *In Search of Excellence* fake data? A magazine suggests it did

Oops! Again. Nearly two decades ago, the top-selling management book of all time made its debut. *In Search of Excellence*, by McKinsey & Co. consultants Tom Peters and Robert Waterman, immediately vaulted onto the best-seller list and ushered in an era of management gurus, management fads, and popular business books that endures to this day.

But now, the outspoken and flamboyant Peters, 59, shockingly admits that he and his co-author falsified the underlying data in that breakthrough book. In an article in the December issue of *Fast Company*, Peters writes: "This is pretty small beer, but for what it's worth, okay, I confess: We faked the data."

Peters may consider it small beer, but this confession is a doozy. *In Search* was the ultimate cult business book. It had a lock on the best-seller list for over three years and eventually sold more than 3 million copies. "Excellence" became a buzzword even after *BusinessWeek* debunked some of the hoopla in a 1984 cover story entitled "Oops!"

"GET OFF MY CASE." For years, many assumed that the authors employed rigorous research and stringent financial screens to identify "excellent" companies. Peters now maintains that he and Waterman simply asked their McKinsey colleagues and other "smart people" for the names of companies doing "cool work." Then, they screened that initial list of 62 organizations for financial performance over a 20-year period. That whittled the list to 43 companies, ranging from Johnson & Johnson to Intel Corp.

Even more peculiar than Peters' confession of inventing data is the author's insistence that his published admission is



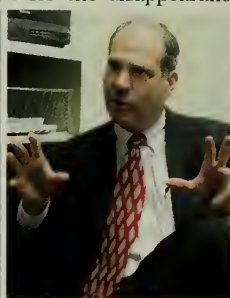
actually untrue. "Get off my case," he grouches. "We didn't fake the data. It's called an aggressive headline."

That's one way of looking at it. The explanation the authors gave in the book of how they picked their role-model companies is almost exactly the same as the version Peters gave in the magazine. So why the "confession"?

The article resulted from a six-hour interview with Alan M. Webber, a founding editor of *Fast Company*. In the writing and editing of the story, says Peters, Webber inserted the line about faking the data. Peters, one of ten early investors in *Fast Company* who has since cashed out, was shown an advance copy of the article and didn't object to the addition. Then, Webber promoted the story on the magazine's cover with the tag line "The Confessions of Tom Peters: 'We faked the data.'"

Peters says he was "pissed" when he first saw the cover. "It was his [Webber's] damn word," he says. "I'm not going to take the heat for it."

For his part, Webber says: "Tom is being too generous in giving me credit. It was hyperbole. It's in service of a bigger point, which is to trust your gut. Anyone who takes this seriously should be tested for the disappearance of their sense of humor."



IT'S A DOOZY: Peters says his interview with Webber (above) wasn't so explicit

Relying on instinct was one of the book's important lessons. It was published at a time when Japan severely challenged Corporate America's dominance. Many believed entire industries were vulnerable to the Japanese onslaught. The book attacked the management-by-

the-numbers mindset and sent a positive message that there were many American companies that had got it right. Peters and Waterman claimed the best one shared eight attributes such as being "close to the customer" and having organizational cultures that emphasized "autonomy and entrepreneurship."

From the start, there was controversy. Academics sniffed that the work was superficial and lacked rigor. And *BusinessWeek* pointed out, many of the companies extolled as best fell on hard times soon after publication, including Amdahl and Data General.

The latest controversy has Waterman none too pleased. "It's Tom being Tom again," says Waterman, who remains friends with his old partner. "He loves to be outrageous. But I'm sad he did that because we got criticized after the book was published for being flippant."

Is Peters sorry he let Webber use the line? "If there is a firestorm, I'll regret it," he says. This is one case where following your instincts might not have been such a good idea.

By John A. Byrne in New York



“This is pretty small beer, but for what it's worth, okay I confess: We faked the data” — TOM PETERS, *Fast Company*

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TELECOMMUNICATIONS

NEXTWAVE: FROM WIPEOUT TO WINDFALL

Its backers will net billions from radio license sales

Last January, things looked bad for NextWave Telecom Inc. founder and CEO Allen B. Salmasi. The high-speed wireless-communications startup he launched in 1996 was in bankruptcy court, having defaulted on \$4.2 billion in radio license fees it owed the government. The Federal Communications Commission was reselling licenses seized from NextWave—to the very carriers it had vowed to compete against. Its shares were trading at just \$3, down 50% since December 1999—yet another casualty of the telecom meltdown.

NextWave may never get off the ground, but the same can't be said for Salmasi and other investors. In June, a federal appeals court ruled that the FCC was wrong to seize the licenses and returned them to NextWave. The company's shares, then trading at \$3, shot up to \$12. Then on Nov. 15, in a remarkable turnabout, NextWave struck a \$16 billion deal to sell its licenses to a group of wireless carriers. NextWave backers will share a \$6 billion windfall after the company pays off the \$10 billion in back taxes and license fees it owes the government.

The drama has caused nothing less than a furor. Former FCC Chairman William E. Kennard, who played a role in the original 1996 auction, sums up the frustration: "It's an outrage," he says. "What you have is a company that will walk away with a \$6 billion windfall for reneging on a promise to pay the government in an auction."

GRAND VISIONS. No one will walk away with more than Salmasi, who started the company in 1996 with \$8.5 million, \$5 million of which he put up personally. The former Qualcomm Inc. engineer now stands to clear at least \$396 million based on his 15% stake in the company. Others haven't done badly, either. Bay Harbour Management, a business that specializes in distressed stocks, increased its holdings over the summer by acquiring shares for \$3 each. Its original \$20 million is now worth at least

\$110 million, says fund manager Doug Teitelbaum. Triumph Capital, another vulture capital firm, expects profits of

\$74 million on its investment of \$31 million. Says Muhit Rahman, managing director at Triumph: "It looks like I am going to make a bunch of money."

Salmasi's original vision for NextWave was grand: He wanted to build a \$3 billion digital network in 95 markets. The basis for that business was NextWave's successful \$4.7 billion bid in 1996 for the crucial radio-spectrum licenses he needed to build the network. Salmasi's eyes were bigger than his investors' pockets, however. Although the company made a \$550 million down payment on the licenses, Salmasi was never able to



SALMASI: He trumped the FCC

raise enough capital to service the debt. In 1998, NextWave filed for bankruptcy protection, and the FCC took the licenses back.

That wasn't the end of the story. Early this year, the government auctioned the licenses again for \$16 billion to Verizon, Cingular, and other carriers. NextWave, however, contested the move, claiming that protections under bankruptcy law prevented the FCC from reclaiming the licenses. In June, a federal appeals court agreed, ruling that

the FCC seizure was illegal and NextWave reclaimed the licenses.

Salmasi apparently went back to building his long-delayed network, even claiming in August that the buildout would be completed by 2003. But that was before the Nov. 15 settlement deal. Few telecom observers now expect him to attempt to build a business without that all-important radio spectrum. Salmasi isn't talking, but he said in a written statement that the deal "takes us down a different path."

"ACTIVELY INVOLVED." Skeptics question whether Salmasi's tiny outfit even would have had the capability to build a national network. Indeed, even as Salmasi hyped the network's technology this past summer, he was in talks with other carriers over the sale of the licenses, says John A. Rogovin, FCC deputy general counsel. NextWave attorney Michael Wack, however, disputes that view. "That's absolutely incorrect," he says. "We were actively involved in the buildout all summer long."

NEXTWAVE'S BIG WINNERS...

INVESTORS

They'll keep \$6 billion of the \$16 billion price tag set Nov. 15. At least \$396 million goes to founder Allen Salmasi, who started NextWave with \$5 million of his own money in 1996.

INSIDERS & ADVISERS

A handful of NextWave employees, lawyers, bankers, and advisers will share securities valued at about \$120 million.

...AND ONE LOSER

U.S. GOVERNMENT

The carriers will pay about \$10 billion to the U.S. government, which first auctioned licenses to NextWave for \$4.7 billion in 1997. But following NextWave's bankruptcy in 1998, the FCC auctioned the licenses again for \$16 billion, which NextWave contested.

If the government is far from thrilled with the outcome, NextWave rivals aren't complaining. More than dozen carriers will divvy up the licenses, which cover 32 of the top 50 U.S. wireless markets. As for Salmasi, he's not likely ever to achieve his goal of building a pioneering high-speed wireless network. But walking away with hundreds of millions of dollars for a failed vision isn't a shabby consolation prize.

By Jeanette Brown in New York

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MARKETING

FALLING OFF THE LAP OF LUXURY

LVMH's detour from high-end brand marketing isn't paying off



A long Paris' swank Avenue Montaigne, shop windows still glitter with jewelry, handbags, and the latest in haute couture. But just down the street, at the headquarters of luxury-goods giant LVMH Moët Hennessy Louis Vuitton, the picture is anything but sparkling. Hard-hit by the global economic slowdown and a sharp fall in tourism since September 11, LVMH has issued three profit warnings in the past two months. Management now predicts operating profits will be down 10% to 15% this year, to about \$1.5 billion, and some analysts think even that is too optimistic. "It's clear that our market is down sharply," acknowledges chairman Bernard Arnault, seated beneath a portrait of Christian Dior.

Is Arnault, the global luxury king, losing his Midas touch? It's starting to look that way. True, nearly all luxury-goods purveyors are hurting, as shoppers lose their appetite for expensive baubles. But LVMH's woes go deeper. Over the past five years, Arnault, 52, has taken LVMH on a world-class shopping spree, moving it into everything from airport duty-free shops to cosmet-

ics retailing to art auctions. Sales have nearly doubled, to a projected \$10.7 billion this year, more than four times the total of its closest rival, Gucci Group. The trouble is, most of these acquisitions aren't making money. LVMH still draws nearly all its profits from old stalwarts, mainly Louis Vuitton leather

What's Spoiling LVMH's Bottom Line?

DIVISION	OPERATING PROFITS*
LEATHER GOODS AND FASHION	\$1,140 million
CHAMPAGNE AND COGNAC	543 million
PERFUME, COSMETICS	207 million
WATCHES AND JEWELRY	19 million
SEPHORA, DFS, AND OTHER RETAIL	(197 million)
PHILLIPS, INTERNET VENTURES, OTHER	(204 million)
TOTAL	\$1,508 million

* 2001 estimate

Data: Merrill Lynch & Co.

goods and its drinks division, which boasts such brands as Hennessy cognac and Veuve Clicquot champagne.

The newer ventures, by contrast, look pretty risky. Duty-free retailer DFS, acquired in 1997 for \$2.5 billion, has increased LVMH's exposure to the downturn in travel. With sales down 35% since September, analysts expect it to lose nearly \$100 million this year. Sephora, a cosmetics and perfume retailer acquired in 1998 for \$260 million, is expected to lose another \$100 mil-

lion or so following a costly U.S. expansion. And while Sephora is likely to move into the black in a year or two, as a mass-market retailer it will never match the juicy 20%-plus margins of LVMH's leading businesses. "The brutal truth is, the newer investments have not paid off," says John Wakely, an analyst at Lehman Brothers Inc. in London.

Many industry-watchers think it's high time LVMH unload some of this deadweight. Yet Arnault dismisses speculation that he's about to put anything on the

IN THE RED

Sephora is a hit with young shoppers, but it's not likely to turn a profit for another year or two

block. DFS is central to LVMH's strategy of tightly-controlled distribution of its products, he says. And while he doesn't rule out an eventual sale of Sephora, he says the chain is on track to produce 8% to 9% profit margins within three years. Another recent acquisition, auction house Phillips, de Pury & Luxembourg, is already selling more Impressionist and modern art than either Sotheby's or Christie's and will be in the black by 2002. Far from weakening LVMH, Arnault maintains, diversification is a key strength: "We're the only group that has the ability to manage different activities that cover the entire range of the luxury business."

STAR BRAND. Certainly, LVMH's competitors are hurting, too. Gucci Group, Bulgari, and Richemont, which owns such brands as Cartier and Montblanc, have all issued profit warnings in recent weeks. Others, such as Prada and Burberry, have had to shelve planned stock offerings. LVMH has some cause for cheer. Its star brand, Vuitton, is on course to reach \$1 billion in operating profits this year. And the group reaped an \$806 million windfall from the Sep-

ember sale of its 20% stake in Gucci to the Paris-based Pinault-Printemps-Redoute group, ending a two-year battle for control of the fashion house.

Yet LVMH shareholders clearly could see some reassurance. The stock is down 33% this year. A major worry is that LVMH draws an estimated 36% of its revenues from sales to travelers, a higher share than any other major luxury group. It also relies on the U.S. for a larger proportion of sales (26%). Compared to other luxury groups, they're more cyclical," says Scilla Huang, who manages the Zurich-based Arden Luxury Goods Equity Fund.

IDENTIAL SUITOR. If Arnault decides to slim down LVMH, he would probably start with Sephora. Since 1999, the retailing chain has lost nearly \$300 million, as LVMH invested heavily to open 79 stores in the U.S. Sephora has proved to be a hit, especially with younger shoppers who like the vast product range and self-service format—a welcome change from stuffy department stores. The chain is also drawing attention from potential suitors. One is Parmeries Douglas, a German retailer that is looking to expand in the U.S. Although the companies are not in talks, sources close to Douglas say that it is already interested.

Finding a buyer for DFS would be tougher. It's swimming in red ink, prompting a current push to seek nearly \$80 million in savings by renegotiating leases and airport concessions. Besides, DFS's more than 150 duty-free shops in airports and center-city "gallerias" selling a wide range of brands are not an easy sell for most global retailers.

Still, it wouldn't be a bad time for LVMH to get back to basics. It recently acquired U.S. fashion label Donna Karan and needs to invest to leverage the brand globally. Arnault might soon have more opportunities to beef up his stable of brands. Debt-ridden Prada, for example, could try to raise cash by selling its 25.5% stake in Fendi to LVMH, which already owns 25.5% of the Italian handbag maker. Even venerable family-owned companies such as leather-goods maker Salvatore Ferragamo might eventually seek tie-ups with a bigger group such as LVMH. As the luxury business consolidates, it has become harder for small companies to raise the money they need to advertise and build global distribution networks, says Armando Testa of Milan luxury consulting firm InterCorporate Group. "Only the biggest companies have the financial strength to resist the ups and downs of the market," he says. Arnault needs to use his financial strength to do what he does best.

By Carol Matlack in Paris

AUTOS

CHINA'S CARMAKERS: FLATTENED BY FALLING TARIFFS

WTO membership means stiffer competition from imports

With China's economy strong and the peak car-buying season at hand, auto dealer Li Ruheng should be prospering. But as he watches customer after customer browse the Buick Sails, Honda Accords, and Audi A6s in his lot at the Beijing Asian Games Village Automobile Exchange, Li is growing anxious. "Many people come by and ask about prices," he laments. "But they never buy."

Chinese consumers are on to something: Soon after China enters the World Trade Organization in early December, tariffs on imported cars are to drop from a range of 70% to 80% of the list price to 50% to 60%. A thirtysomething Beijing graphic designer who recently inspected a four-door Sail in Li's lot balked at the \$13,855 price tag. He figures similar imported models will soon sell for \$12,000 and that domestic makers will lower their prices, too. "I'm going to wait a few months until after China enters the WTO to see how prices change," he says.

SLOW REBOUND. The wait should be worth it. Next year alone, sedan imports are expected to leap 50%, to 120,000. As a result, car prices should tumble by one-third in a few years, predicts Jia Xinguang, a researcher at the China National Automotive Industry Consulting & Development Corp. in Beijing. By 2006, duties are to sink to 25%—still high by world standards but low enough to put autos within reach of China's swelling upper middle class.

What's good for buyers is bad news right now for China's auto industry. As consumers balk, sedan sales in October fell by 20%, to 60,000 units—a nine-month low, says Automotive Resources Asia Ltd.

in Beijing. A quick rebound seems unlikely. Due to a tariff cut, the price of a locally made four-door Citroën Fukang has dropped 5%, to around \$15,000, since January. Yet comparable cars still cost about \$6,000 less in Europe. "Chinese consumers want to pay the same price for the same quality cars that people pay in other countries," says researcher Jia.

Carmakers already producing in China are preparing for intense competition. As the state phases out rules dictating which models each manufacturer can assemble,

General Motors, Volkswagen, Ford, Honda, and Toyota all plan to launch new cars aimed at quality- and cost-conscious buyers. Ford Motor Co. next year intends to market a compact with a 1.6-liter engine for under \$12,000: It will be based on Ford's Ikon model, now made in India. GM, whose only offering after it opened its Shanghai plant in 1998 was a \$45,000 luxury car, rolled out its Buick Sail in late 2000. On Nov. 20, GM said it will make Sail hatchbacks. "Domestic manufacturers will have to become a lot more focused on customer desires," says GM China CEO Philip Murtaugh. Volkswagen plans to introduce its subcompact hatchback Polo, at \$15,000 to \$17,000, and Toyota Motor Corp. will produce a similarly priced passenger car.

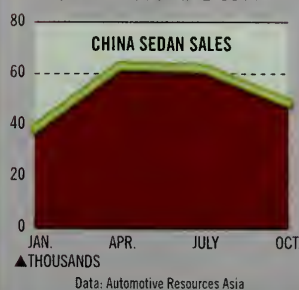
Eventually, lower prices and wider choice should create a thriving auto industry. Jia predicts that car sales will rise by 15%, to 900,000 units, next year and will hit 2 million by 2005. First, though, prices will have to plunge—and dealers like Li will feel the pain.

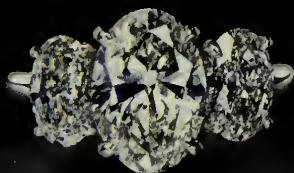
By Dexter Roberts in Beijing, with Alysha Webb in Shanghai

BECALMED: At a Beijing dealer, no buyers for a Buick Sail



GEARING DOWN





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DREAMS
TO THE LOVE
OF YOUR LIFE



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LICENSING

BOFFO AT THE BOX OFFICE, SCARCE ON THE SHELVES

Vary toymakers are cutting back on film tie-ins

On Nov. 17, just one day after the release of the movie *Harry Potter and the Sorcerer's Stone*, Sabrina Smith went to a Toys 'R' Us store in Santa Monica, Calif. She was hoping to buy a Harry Potter toy for her seven-year-old niece. But instead Smith found a lot of empty shelves. "The Lego classroom is gone. The dolls are gone," she said. "Somebody has just leaned them out."

Don't parents spend every November and December scrambling to find the toys that are spun out of the season's hit kiddie movies? Sure. But industry observers warn that scarcities of movie-related toys this year could hit far earlier and more severely than in past holiday seasons. Burned in recent years by huge unsold inventories of movie merchandise and fear of the slowing economy, everyone from toymakers and retailers to moviemakers has cut back. People are more concerned with not having stuff left over than [with] getting every last sales dollar," says Martin Brochstein, executive editor of *The Licensing Letter*, an industry trade publication.

VARY. In the licensing business, they call it Post *Star Wars* Stress Syndrome. Although the movie *Star Wars: Episode I—The Phantom Menace* generated more than \$1 billion in merchandise sales the year after its 1999 release, toymakers and retailers had counted on doing even better. They stocked up on far more toys than could be sold in any one galaxy, and suffered mightily when the stuff didn't move. The movie's main toy licensee, Hasbro Inc., saw its earnings and stock collapse in 2000 as a result.

So while this year's holiday coincides with kiddie megamovies like *Harry Potter*, *Lord of the Rings*, and *Monsters, Inc.*, many toymakers remain wary. For the rights to *Harry Potter*, Mat-

tel Inc. is paying AOL Time Warner Inc. a 15% royalty rate and minimum guaranteed royalties of \$20 million, plus options allowing Warner to buy \$3 million of Mattel's shares below market price. Compare that with what Hasbro paid Lucas Licensing Ltd. to get *Phantom Menace*: a 20% royalty and a guaranteed \$600 million in sales, plus stock options according to industry trade journal *KidScreen*.

That's not the only big change Mattel has made. To reduce its dependence on Hollywood movies, and the need to pay big fees for movie-related toys, the company ended a long-time deal marketing products for new Disney films last year—and went into the movie business. On Oct. 2, its first computer-animated feature, *Barbie in the Nutcracker*, was released. Andrienne Fontanella, chief of Mattel's Girls division, says she expects to sell 4 million copies of the \$19.98 video and more than \$100 million in related Barbie merchandise.

Toymakers aren't the only ones who turned cautious. Studios have also cut back the merchandise in recent deals to avoid oversaturation. Warner Brothers Studios, for example, signed less than half as many merchandise deals for *Harry Potter* as it has with past children's films.

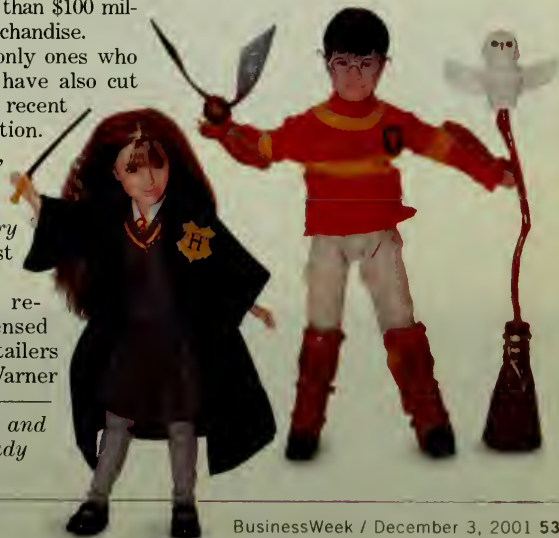
And shoppers' initial responses to recently licensed merchandise spooked retailers further. Late last year, Warner

launched a few products to coincide with the release of the most recent *Harry Potter* book. Some items, like apparel, didn't sell. "People were concerned about the retail environment and cautious [about] licensed product. They cut back on orders," says Jerry R. Welch, chief executive of retailer The Right Start Inc., which owns Zany Brainy stores and agreed to acquire toy chain F.A.O. Schwarz on Nov. 19.

With everyone in the industry fretting at once, the result was almost inevitable: far less merchandise in the stores—and popular stuff already disappearing from the shelves. "Stores are all running out of stock," says Matt Bousquette, president of Mattel's Boys/Entertainment division. "We are trying to air ship some product, but what you see is what you're gonna get."

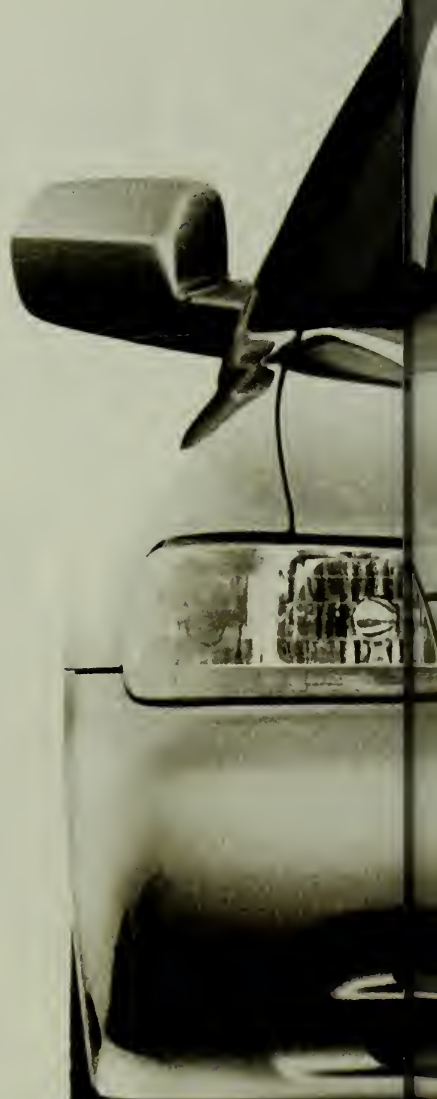
All this is likely to make for some pretty unhappy parents and kids come Christmas morning. But Wall Street is certainly feeling jolly. This year, shares of Mattel are up 40%, to 19, while shares of Hasbro, which is making toys for *Monsters, Inc.*, have climbed 75%, to 18. "There is a new discipline that's healthier for the companies and the industry," says Merrill Lynch toy analyst Hayley Kissel. Great. But does she know where to find a Harry Potter Lego set?

By Christopher Palmeri in Los Angeles and Diane Brady and Nanette Byrnes in New York



HOT STUFF: *Monsters, Inc.*, *Barbie*, and *Harry Potter* merchandise is already starting to sell out of stores

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EDITED BY MONICA ROMAN

A SCORCHING IPO FOR MAGMA

IT APPEARS THE INITIAL-public-offering craze isn't dead after all. Magma Design Automation made a red-hot debut on Nov. 20 on the Nasdaq as investors starved for IPOs snapped up shares in the software company that helps design computer chips. The Cupertino, Calif., outfit trades under the ticker "LAVA" and is one of several specialty shops that help companies such as Infineon and Texas Instruments look for competitive advantage by speeding the time it takes to bring a new chip to market. Although it was expected to go public at a price ranging from \$9 to \$11, Magma sold 4.85 million shares at \$13 each to raise \$63 million in the offering led by Credit Suisse First Boston. The company then saw its stock soar 46% to \$18.99 on its first full day of trading. Eight IPOs have raised \$6 billion since Sep-

tember 11, with nine more on the docket through yearend.

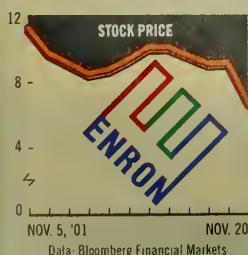
MICROSOFT GETS A SLAP ON THE MOUSE

THINGS CERTAINLY ARE COMING up roses for Microsoft. First it settled with the Bush Administration on very lenient terms. Then, on Nov. 20, it announced plans to settle dozens of private antitrust suits. As part of the settlement, the company is to donate its software and reconditioned computers to 14,000 low-income schools. Microsoft is not totally out of the private-litigation woods, though. The most potent suit—a massive class action in California—is not part of the deal. And it's still possible that a rival like AOL or Sun Microsystems could sue. But this is clearly good news for Microsoft. The settlement, legal experts say, reflects the poor prospects for these suits—which had to quantify the damage to consumers.

CLOSING BELL

ENERGY CRISIS

Where's bottom for Enron? The energy trader's stock fell 23%, to \$7.01, on Nov. 20, the day after it disclosed the extent of its liquidity crisis in a Securities & Exchange Commission filing. Its most immediate concern: avoiding a \$690 million debt payment that could be due by Nov. 27. Enron says talks with lenders have been "encouraging."



THE PROSPECTS FOR CONOCOPHILLIPS

PHILLIPS PETROLEUM AND Conoco announced an all-stock merger on Nov. 18, but since Conoco is getting no premium for its stock, other bidders could emerge. If completed, the deal would create the sixth-largest oil company in the world, based on reserves, and one more competitive with such supermajors as ExxonMobil and Royal Dutch/Shell. Annual cost savings could hit \$750 million in the first year after closing, a nice boost in the face of falling oil and gas prices. ConocoPhillips will be based in Houston, Conoco's hometown, but Phillips shareholders will own 56.6% of the new company. Analysts figure the deal will meet little resistance from regulators.

HEADLINER: TONY ALVAREZ

WARNACO'S NEW TAILOR

HE MAY NOT BE AN EXPERT in bra styles and bikinis, but Tony Alvarez knows how to turn a sick com-

pany around. He had better: Alvarez, 53, has replaced the bombastic Linda Wachner as CEO of bankrupt Warnaco. Before joining the apparel maker in May as chief restructuring officer, he helped revamp Resorts International and Charter Medical, among others. Alvarez blames Warnaco's problems on tough industry conditions and acquisition overload. "The speed of growth was maybe a bit much," he says. But Alvarez insists Warnaco has

a stable of wonderful brands, including Calvin Klein jeans, Speedo swimwear, and Olga bras. Moreover, a rough job market should make it easy to recruit new talent. After all, Alvarez doesn't want to surround himself with lingerie forever. He plans to stick around long enough to see Warnaco through its reorganization, which could take anywhere from six to 18 months. His big challenges: mending industry relationships, energizing Warnaco's staff, and raising the company's status on Wall Street.



Diane Brady

QUIET EXIT AT FIDELITY

THE FORMER HEAD OF FIDELITY Investments' brokerage operations is leaving the mutual-fund giant. Robert Mazzarella, 55, had played a key role in the growth of Fidelity's brokerage group since the early 1980s and helped launch its online brokerage business. But in March, he lost out when Kevin Kelley was named president of a newly formed Fidelity Brokerage Co. unit. Another executive, former AT&T marketing star Gail McGovern, took over key roles in Fidelity's retail brokerage business.

CRUISE LINES PLAY LOVE BOAT

LONDON-BASED P&O PRINCESS Cruises and Miami-based Royal Caribbean Cruises announced on Nov. 20 they're merging to form the world's

largest cruise company. The deal, which brings together Royal Caribbean, Princess Celebrity and other cruise lines, will create a company with annual revenues of more than \$5 billion. Cruise companies have been hurt by the decline in travel after September 11. But Richard Fair chairman and CEO of Royal Caribbean Cruises and chairman and CEO-designate of the combined group, says that Royal Caribbean and Princess have been trying to merge since 1991 and that recent talks preceded the terrorist attacks.

ET CETERA...

- The Food & Drug Administration approved Pharmacia's new arthritis drug, Bextra.
- In a sign of industry consolidation, Exelixis will buy Genomica for about \$110 million.
- Philip Morris has proposed changing its name to Altria.



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EDITED BY RICHARD S. DUNHAM

BASEBALL OWNERS COULD BOBBLE THIS BALL

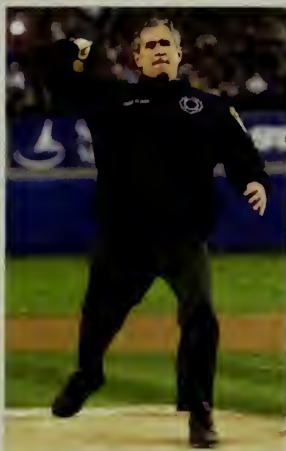
Baseball got a Bronx cheer from fans on Nov. 6 when, for the first time in a century, it announced plans to eliminate two teams. Now, Congress is on its case, and caught between the bases is the First Fan himself—former team owner George W. Bush. He is being pressured by friends and others to punish baseball, protect baseball, or help bring a club to Washington.

As Major League Baseball moves ahead with its controversial contraction, outraged lawmakers are threatening to retaliate by chipping away at its cherished antitrust exemption. While Congress has made such threats before—they were employed to force MLB to add teams in Arizona and Florida—this time, legislators just might have the votes to humble the owners.

For years, baseball has used its political clout to maintain the antitrust waiver that protects the 30 teams from big fines for collusion and allows them to decide which cities get a club and which don't. With a roster of A-list owners and lobbyists, baseball is better positioned in Washington than any other sports league. Its owners include Chiquita Brands Chairman Carl H. Lindberg of the Cincinnati Reds, a Bush fund-raiser, and Peter G. Angelos of the Baltimore Orioles, a major Democratic donor. Owners gave candidates more than \$3.9 million in the last election cycle, according to the Center for Responsive Politics, and MLB recently formed a political action committee. Its nearly \$1 million lobbying payroll includes Nancy Calautti, wife of Senate Budget Committee Chairman Conrad (D-N.D.), and William H. Schweitzer, an attorney for the Republican National Committee.

But the owners, for the first time, might be out of their league. Senator Paul D. Wellstone (D-Minn.), who stands to lose his Minnesota Twins, and House Judiciary Committee ranking member John Conyers Jr. (D-Mich.) have introduced a bill to al-

low lawsuits that could block teams from packing up. And the House Judiciary Committee has summoned Baseball Commissioner and Bush pal Bud Selig to appear at hearings in December. "Baseball has never had to worry about Washington in the past, and they're assuming that they won't have to worry about Washington in the future," says sports economist Andrew Zimbalist of Smith College. "But this case is so...extraordinary that if [Congress] is ever going to have a chance, this is it."



FIRST FAN: Will he step in?

D.C. FRANCHISE? Others in Washington don't want revenge, they just want a team. The capital has been baseball-starved since 1972, when the Senators left town. Now, Bush buddies are working behind the scenes to leverage the contraction flap into a Beltway franchise. "The [owners] need to be worried about thumbing their nose at the nation's capital," says key player Frederic V. Malek, a former Northwest Airlines CEO, Bush family friend, and part-owner with George W. of the Texas Rangers.

Across the Potomac, influential Virginians want a team, too. Would-be owner Bill Collins, CEO of wireless company Metrocall, is a major GOP donor who counts among his investors Michael Scanlon, a longtime friend of top Bush adviser Karl Rove. Also in the mix: GOP National Chairman and Virginia Governor Jim Gilmore and National Republican Congressional Committee Chairman Thomas M. Davis III (Va.). All hope the threat of revoking the antitrust waiver will persuade MLB to reconsider contraction and deliver a team to D.C.'s suburbs.

Baseball so far has committed multiple errors in Washington. Among them: targeting the Twins, "home" team of Senate Majority Leader Tom Daschle (D-S.D.), and clubs in Florida, where the President's brother Jeb is governor. For now, the First Fan is keeping mum, but it's only the first inning.

By Lorraine Woellert

CAPITAL WRAPUP

THAT'S VICE-CHAIRMAN GORE

► From the time he traded his reporter's notebook for a congressional seat in 1976, Al Gore has worked in the public sector. Now the former Vice-President is going corporate—and perhaps postponing his Presidential ambitions.

Gore announced on Nov. 19 that he's taking a job at Metropolitan West Financial Inc., a Los Angeles-based financial services firm that manages more than \$50 billion in assets. As MetWest's vice-chair, Gore will focus

on biotechnology, info tech, and international markets. After a quarter-century as a policy wonk, Gore says he's "eager to learn more about business as an active executive."

Political insiders see Gore's move to the corporate suite as another sign that he is preparing to sit out the 2004 election. Another hint: His campaign manager, William M. Daley, announced one day earlier that he, too, is taking a plum corporate job. Daley is set to become president of San Antonio-based telecom giant SBC Communications on Dec. 1. In his new job, he will over-

see strategic planning and lobbying.

Recently, Gore has shown signs of backing away from a possible rematch against President Bush, whose popularity has hovered near 90% for two months. Gore has strongly supported the war against terrorism, and he refused to wade into the muck of the Florida election mess after a media consortium released the results of its ballot review on Nov. 12. "The Presidential election of 2000 is over," Gore said on Nov. 12. For the former Veep, the 2004 election may be over, too.

By Richard S. Dunham

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A REPORT ON ELECTRONIC BUSINESS

E-TAILING
Bringing Dead
Dot-Coms
Back to Life

WEB SMART
The Payoff from
BP's Web Gusher

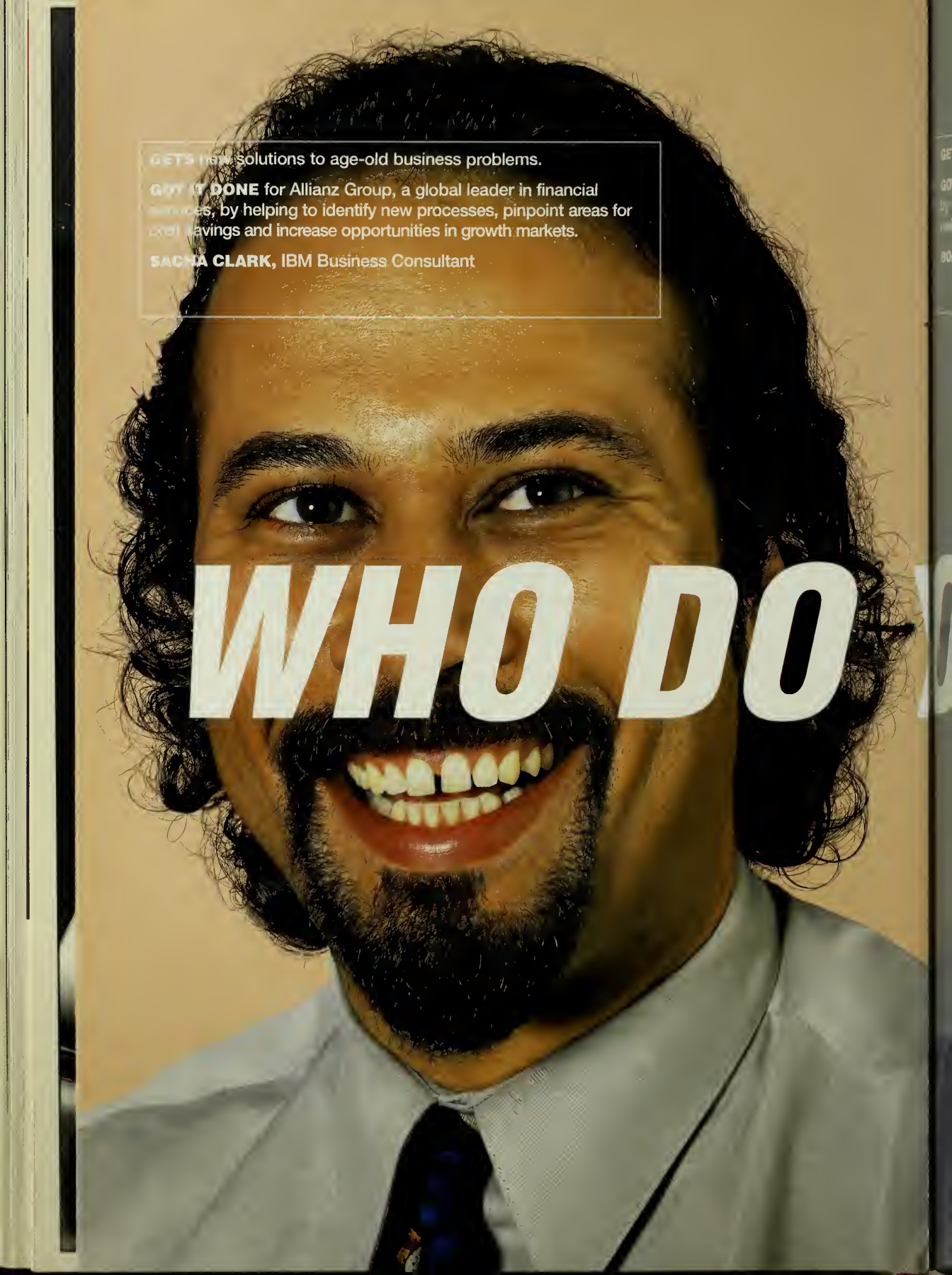
A close-up portrait of Meg Whitman, CEO of eBay, with blonde hair, looking slightly upwards and to the right with a subtle smile. She is wearing a dark top.

CEO Meg Whitman

The Secret of eBay's Success

What Corporate America Can Learn

BY ROBERT D. HOF



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SACHA CLARK, IBM Business Consultant

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BOAS BETZLER, IBM Senior Software Engineer

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El Paso Global Networks. Bandwidth. Raised to the power of El Paso.

 **elpaso** | Global Networks



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COVER STORY

The Secret of eBay's Success

Sure, the online auction giant has a great business model. And yes, it's growing like a weed. But what makes eBay work is that its 38 million buyers and sellers wield the kind of influence that most consumers could never exert on regular businesses



FEATURES

8. Home Page

Jacksonville, Fla., makes it easy to take your laptop to the beach; e-biz is flunking out on campus; and a site that helps you guess if you're about to be fired

24. Strategies

The Year of the E-Piggyback

This holiday season, traditional retailers are riding on the backs of dot-coms—dead and alive—to serve their customers better

28. Web Smart

When Oil Gets Connected

As times turn tight, BP's Internet ventures will add \$300 million in new revenues and savings this year



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COMMENTARY

10. Neuborne on E-tailing

It's All About Trust

Rocked by economic woes and war terrors at home and abroad, consumers are looking for a feeling of safety and security in their annual holiday buying binge. So reliability may be the e-factor that holds them



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12. Clicks & Misses

Sites That Have Faith

Want to teach your kids about your religion, or those of others around the globe? The Web boasts several excellent sites that can help. Most feature news and basic facts, some even have games and chat rooms

32. Digital Lifestyle

HP and Compaq: Happily Ever After?

Wherein Miss Nuptials gets a letter from Carly asking if she and her beloved should tie the knot, and answers that little good may come of the alliance, so backing out might be the better course

Bathing Suit, Beach Towel, Laptop...



For a vacation without interruptions from the office, you might want to scratch Jacksonville, Fla., off your list. The Sunshine State's northernmost city has become the first major U.S. resort town to build a wireless network serving its riverside tourist district. So it's official: There's nowhere to duck your e-mail.

Users of BlackBerry pagers have long had this problem, but Jacksonville extended it to laptop-bearing folks. The city spent less than \$20,000 on a high-speed network dubbed WIZ, for Wireless Internet Zones, that can serve almost any laptop or handheld in the tourist-laden riverfront strip popular with boaters. About 4,000 people have logged on since WIZ went live in August.

City and corporate leaders hope the network will go regionwide, attracting high-tech companies to town. In the meantime, you can swim but you can't hide—from work. —Charles Haddad

E-biz Is Flunking Out on Campus



First, MBA students shunned jobs at startups last spring to go B2B and B2C ("back to banking" and "back to consulting"). Now, Massachusetts Institute of Technology students have persuaded administrators to change the name of the school's two-year-old e-business curriculum to Digital Business Strategy. The program's 90 students "were worried about how they would be perceived in the job market," says MIT spokesman Steve Buckley.

MIT wasn't the only school to get dot-com happy in 1999: By spring, 2001, 25% of U.S. business schools had e-commerce majors for MBAs. Others poured e-business courses into existing curriculums.

Now the dot-com bubble has burst in academia, like everywhere else. MIT's e-business enrollment is down from 140 last year. Top schools are offering fewer e-courses—the University of Pennsylvania's Wharton School has six, down from 10 two years ago. Instead, courses like marketing, finance, and strategy now include Web topics. "E-biz is not something separate," says Raphael Amit, director of the Wharton Electronic Business Initiative. Now he tells us.

—Faith Keenan

Are You About to Lose Your Job?

Before you blow all that dough around the holidays, are you sure you won't be fired? The economics Web site Dismal.com rates your chances with its new "Layoff Calculator," which uses forecasts by region, industry, occupation, as well as company stock prices, to tell you if you're O.K. or roadkill. Compare your odds of losing your job by the end of next year to the national median of 5%.

Programmer, Microsoft, Redmond, Wash.	4.6%
Programmer, Seibel Systems, San Mateo, Calif.	5.3
Tech Banker, Merrill Lynch, New York	7.9
Cutstomer Service Rep., Amazon.com, Tacoma, Wash.	8.2
Engineer, Hewlett-Packard, Palo Alto	8.4
Manager, Compaq, Houston	9.8
Production Worker, Ciena, Linthicum, Md.	13.4

Data: Dismal.com

Assumes each worker's performance rating was average.

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BY ELLEN NEUBORNE

ellen_neuborne@ebiz.businessweek.com

It's All About Trust

With shoppers feeling jumpy, reliability is the e-factor that will lure them this Christmas

THIS YEAR, I'LL BE PLUNKING my entire gift budget down at LLBean.com. Mom, Dad, kids, cousins, you're all getting flannel. It's not because of a coupon or shipping giveaway or sleek features on the site. It's because Bean has been in business since 1912. The company likes to hire the same folks back every year to work the phones and staff warehouses. The grandson of the founder runs the place.

And it has been online more than a year. I trust that the company knows what it's doing. And this year, that's all I need.

Trust has emerged as a crucial factor in the holiday shopping season. Consumers, rocked by economic woes and war terrors at home and abroad, are looking for a feeling of safety and security in their annual holiday buying binge. E-tailers hoping to lure holiday shoppers will need to incorporate this mindset into their marketing messages to drive traffic to their sites. It's not enough this year to tell consumers that you'll be cheap or convenient or even on time. This year, you need to be clear that you are untouched by the madness—that your shipping partners are safe, your warehouse is secure, your vendors are old friends, and you're not so close to fiscal ruin that you'll disappear before the season is over.

E-tailers should be using their ads to make that trust pitch this season. Online merchants have a unique window to connect with shoppers this year. Plenty of experts have pointed out the obvious potential for e-tailing. Nervous consumers, looking to avoid the real or perceived dangers of public shopping malls, may opt for the safety of the virtual store and the private package-delivery service. In a survey of 400 shoppers conducted Sept. 17 by Vividence Corp., consumers said their top concerns this holiday season were safety and family, and that those emotional issues topped the reasons they would consider shopping online. "The fallout from the tragic events of September 11 may provide an unexpected opportunity," says Jeff Greenfield, CEO of Vividence.

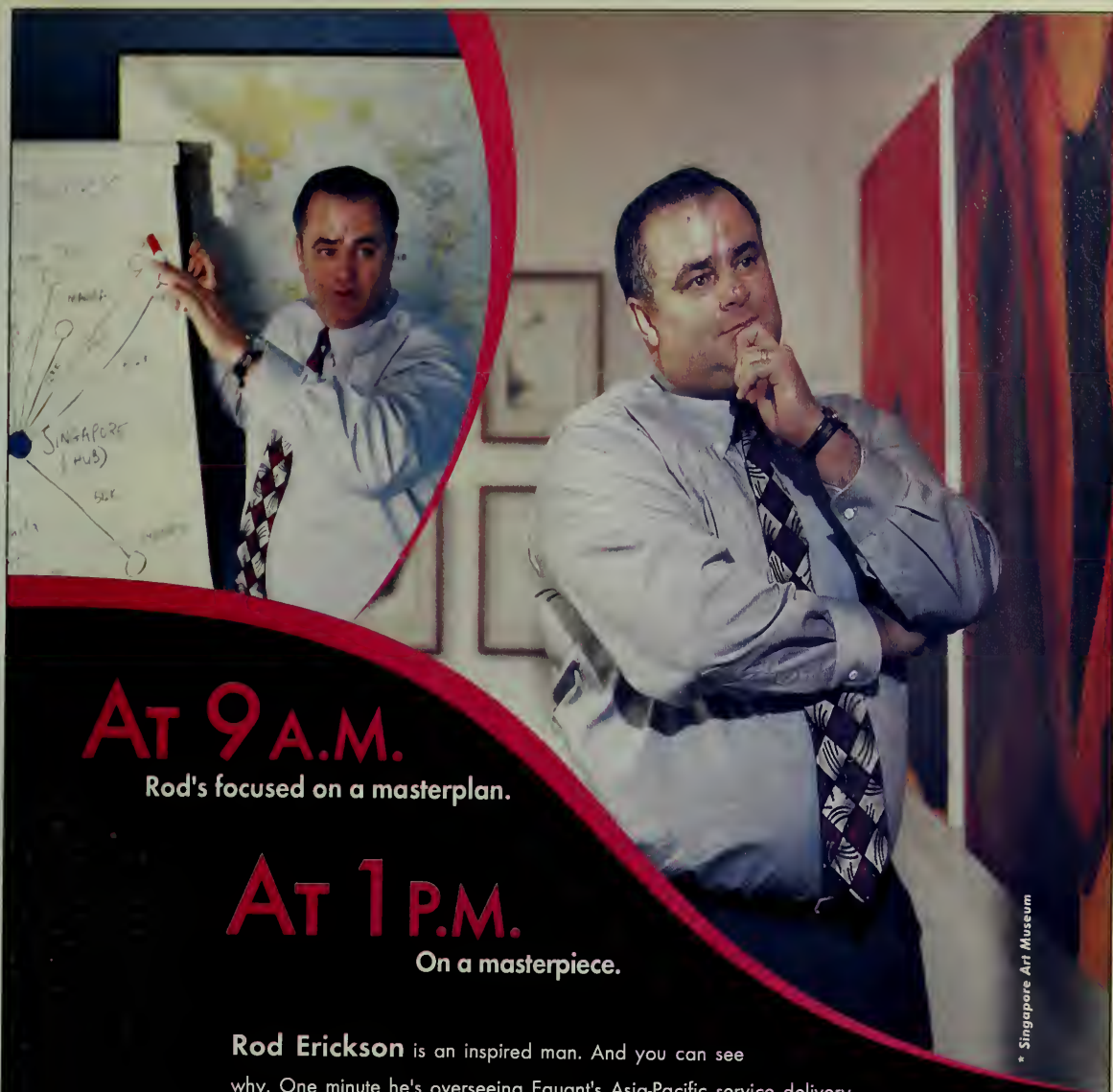
To seal the deal, e-tailers will need to reach out and make the

case to consumers that they are, in this age of uneasiness, trustworthy. Established traditional retailers have an edge here, given their long track records. Take J.C. Penney Co. A recent Web ad for its online store reads: "J.C. Penney: Security. Trust. Quality." But Internet companies can trade on trust, too. Newly relaunched eToys.com devotes a section of its Web site and its e-mail ads to the 80-year-old history of its new owner, KB Holdings

Inc., parent of KB Toys. Beauty site Gloss.com hopes to encourage trust in its site by piggybacking on the marketing of its well-known cosmetics makers. Pitches to visit the Web site will be included in print and e-mail advertising of the brands it carries, including Clinique. The tactic taps an important consumer emotion, says Gloss President Peter Hirshberg. "We want to create a trust relationship. That's suddenly a lot more top-of-mind for consumers," he says.

Not everyone has noticed. So far, most Internet merchants are clinging to their old standby marketing tactic: cheap deals. Amazon.com is offering \$5 off a \$50 purchase. Nordstrom.com has a free shipping offer. Macys.com touts a gift with purchase. It's marketing based almost entirely on price and it's off the mark with consumers. New Yorker Patti Aliventi will spend most of her holiday budget online this year, but she doesn't plan on trying out any newbies or scouring the Net for the best deals. Instead, she'll focus on e-stores with solid reputations. "These days, trust is a big factor. I like to know that Internet retailers know what they are doing." Consumers like Aliventi are in a more emotional mood—one that e-tailers have to embrace to make a success of the season. ■





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At 1 P.M.

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* Singapore Art Museum

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BY TIMOTHY J. MULLANEY
tim_mullaney@ebiz.businessweek.com

Sites That Have Faith

From games for kids to crash courses in Islam, the Web's got religion

WHEN I HAD anything to say about it, discussions of Christmas in the Mullaney household when I was young began with Santa and ended with Claus. My parents, of course, asked me to think deeper. Since my son arrived in May, I'm facing this year's holidays with an eye toward how I'll teach him about observance as he grows. And like any parent, I've wondered how I could explain the religious fervor

behind September 11. It turns out that several excellent Web sites help parents learn—and teach—the basics of the world's religions.

My top pick is Beliefnet.com, a religious portal that is Christian at its roots but covers all the major faiths. Those who want to learn about Judaism in time for Hanukkah, which begins on Dec. 9, could consult the portal Zippie.com. And people who are thinking of Islam for the first time in the wake of September 11 could start with Islam101.com.

I've written or edited reviews of hundreds of Web sites, and Beliefnet may be my favorite. It's smart and entertaining, deftly mixing articles with games, and an active community that posts running chat alongside articles. How many Web sites can ask for send-ups of C.S. Lewis' religious novel *The Screwtape Let-*

ters and get 250 entries? That's Beliefnet.

Beliefnet presents wide-ranging views. Evangelical ex-Presidential candidate Gary Bauer is a contributor—as is liberal Jewish thinker Michael Lerner, once a spiritual adviser to First Lady Hillary Clinton. In mid-November, the site featured a column by Richard Mouw, president of Fuller Theological Seminary, about his plan to fast for Ramadan. He's fasting as a hard-times reminder that Islam, Judaism, and Christianity have common roots.

Beliefnet is a tough act for Zippie and Islam101 to follow, though they're fine in their own ways. Most of the year, Zippie is interesting for its Israel-centric view of Mideast politics, including coverage carried by Israeli papers. Its Holidays channel includes explanations and how-tos for Hanukkah celebrations, and links to everything from reverent songs to comedian Adam Sandler's *Hanukkah Song*, a completely different kettle of gefilte fish. Its activities for kids are especially winning, including coloring books, songs, and spinning-dreidel games.

These days, Islam101.com is devoted mostly to September 11. It also has basics on Ramadan, Islam's monthlong ritual of daytime fasting to build discipline, charity, and obedience to God. For more on Ramadan, which began on Nov. 16, surfers might try Soundvision.com. Its highlights include a "Grade One Student Presentation about Ramadan" and guidance for Muslims on explaining their religion to nonbelievers. Non-Muslims can follow along—and learn.

All this is a long way from my Irish Catholic holidays of yore, but we live in a smaller world and need to know our neighbors. None of these sites fits under a tree. But they're gifts nonetheless. ■



Keeping the Faith

At a time when religion and current events are intertwined, here are some Web sites that explore the beliefs of world religions.



Beliefnet.com: Multifaith site offers articles, games, and more to serve either kids or adults. Active chat boards, too.



Zippie.com: Excellent for Middle East news and views. Handy guide to holidays teaches the basics.



Islam101.com: What the name implies: An introductory guide for non-Muslims. Has links to Soundvision.com, which may suit Muslims better.



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eBay's brass:
Maynard Webb,
CEO Meg Whitman,
and Brian Swette

The People's Company

eBay is run like a democracy, with customers playing a major role. But will that relationship become a casualty of the auction site's success?

BY ROBERT D. HOF

IT SEEMED LIKE a boffo idea to the brass at the Internet auction site eBay Inc.: By referring losing bidders to similar auctions by other eBay sellers, they'd keep bidders coming back. Within minutes of the program's debut in early June, though, all hell broke loose. Hundreds of angry sellers jammed eBay's online discussion boards,

furious that their bidders were being siphoned away. One veteran seller of stamps and postcards, Bob Miller, auctioned a rare eBay jacket as an excuse to post a long screed slamming "eBay's new policy of screwing the folks who built them."

Even among the 7 million ongoing auctions, this one quickly caught the attention of Chief Executive Margaret C. Whitman and founder Pierre Omidyar. Within a week, they met with Miller in

tion listens nearly as well as they do," says Miller, who's now happily running several thousand auctions on eBay.

Meet the People's Company. Like a democracy, it can be a noisy and unruly place, where citizens sometimes think the folks in charge are numbskulls. But the people's passion prevails at eBay because the people are firmly in charge. Its customers—the 38 million buyers and sellers who trade on its site—wield the kind of influence over the online auction site that most consumers and businesses could never dream of exerting on conventional companies.

Oh, sure, eBay has a delicious business model that doesn't require carrying any inventory. And, yes,

it's growing like a weed and minting juicy profits because bargain hunters, in good times and bad, flock to the auction site. But the real secret of eBay's unlikely success is this: It's a master at harnessing the awesome communications power of the Net—not

just to let its customers sound off directly in the ears of the big brass, but to track their every movement so new products and services are tailored to just what customers want. Remember that famous tagline, "When E. F. Hutton speaks, people listen"? At eBay, it's the other way around: When people speak, eBay listens.

One month in late 1998, for instance, eBay managers noticed an uptick in listings in various miscellaneous categories, such as die-cast cars—suddenly, people were selling *real* cars. Now, eBay's the country's biggest car dealer, with \$1 billion in sales of cars and car parts this year. In January, shortly after an eBay seller suggested speeding up auctions for impatient bidders, eBay debuted a Buy It Now feature that lets bidders end an auction at a set price. Now, 40% of listings use it, attracting more mainstream buyers and helping close auctions nearly a day faster on average than a year ago.

In essence, customers are eBay's de facto product-development team, sales and marketing force, merchandising department, and security detail—all rolled into one. It's not just that they have catapulted eBay, in just three short years, from a funky little online garage sale full of Beanie Babies and attic trash into a global marketplace for almost anything, from a \$1 baseball card to a \$4.9 million Gulfstream jet. eBay's customers also take it



IN AUGUST, A GULFSTREAM JET SOLD FOR A RECORD \$4.9 MILLION

eBay's suburban Salt Lake City office near Miller's

home. As they listened for 45 minutes, Whitman took four pages of notes. Two days later, they promised to switch course. E-mails would first recommend the same seller's other auctions, or the seller could simply opt out. "No other large corpora-

COVERSTORY

upon themselves to tell the world about eBay through word of mouth. They crowd eBay's online discussion boards, posting 100,000 messages a week to share tips, point out glitches, and lobby for changes. eBay's customers even police the site by rating each other, keeping fraud minimal.

By using the Net to tap into the talent and imagination of its customers, eBay has multiplied the brainpower of its executives by millions. Imagine a retailer trying to do this: It would have to interview every single person leaving every store, post a list of what each thought of the shopping experience, then ask them to write up a merchandising plan and call suppliers to arrange deliveries—and oh, by the way, could they keep an eye out for shoplifters? That's what eBay's customers voluntarily do each day. Says Whitman: "It is far better to have an army of a million than a command-and-control system."

The success of this let-'em-loose-and-

listen strategy holds some potent lessons for Corporate America. By staying in close touch with customers, eBay can reinvent itself every day, since it knows precisely what its clientele wants. The trick is to keep up with what buyers and sellers want. "We've had to constantly change how we run," says Chief Operating Officer Brian Swette. "We start from the principle that if there's noise, you better listen."

And, because it set a firm corporate goal from the start—to create "global economic democracy"—it has managed to maintain focus even while growing at a crazy clip. First-time eBay buyers are often shocked at the intensely personal service they get from eBay merchants, from handwritten thank-you notes to free shipping. It's an example of how building a strong brand depends more on understanding that each and every transaction can create a personal, one-on-one relationship that will endure. Says eBay board member Howard Schultz, CEO of Starbucks Corp.: "The imprinting of the eBay brand was not based on 30-second ads,

but the relationship with the users."

That's why neither the September 11 tragedy nor the recession has put a pall on eBay's prospects. Despite losing about \$5 million in revenues from a drop in activity following the terror attacks, eBay beat third-quarter estimates. Sales rose 71%, to \$194.4 million, surpassing expectations by 3%. It earned an \$18 million profit, 15% above analysts' forecasts. eBay even raised its fourth-quarter sales forecast by 5%, to \$200 million or more. Analysts now expect 2001 sales to jump at least 70%, to \$736 million. Next year looks just as promising. Analysts figure sales will rise 40%, to \$1 billion, and profit will be up 56%, to \$150 million. Rivals are in awe: "These guys have done a killer job," admits Amazon.com Inc. Chief Financial Officer Warren C. Jensen.

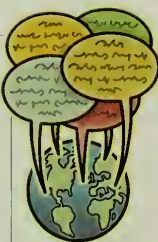
Now, eBay appears poised to buck what looks to be a gloomy holiday season for almost every retailer, online and off. That's largely thanks to the smarts and the moxie of its customers, who—unlike big retailers—can switch gears instantly on

eBay:

OF THE PEOPLE, BY THE PEOPLE, FOR THE PEOPLE

From its start in September, 1995, most of eBay's features were suggested by users or created as a direct result of their activity on the Web site. That has paid off for eBay in lower support and marketing costs, higher loyalty, and quick pushes into new markets

LET'S TALK Swamped by e-mails from people asking for help, founder Pierre Omidyar creates an online bulletin board for users to share tips. Since then, more than a dozen forums and chat rooms, with 100,000 posts a week, have sprouted up, creating a community of eBay loyalists.



Fall 1995

FEEDBACK FRENZY Users constantly e-mail founder Omidyar with suggestions. During the day, he answers them. At night, he makes changes to the software to incorporate the suggestions. That makes users eager to offer advice—keeping support costs down.

Spring 1996

HEARING VOICES eBay convenes its first "Voice of the Customer" group, flying 10 users from around the country to eBay's San Jose headquarters. Formed every few months, the gatherings serve as ongoing focus groups to help eBay improve the site.

April 1999

RATING ONE ANOTHER After watching customers discuss ways to gauge the trustworthiness of other buyers and sellers, Omidyar sets up a way for people to give each other ratings on every transaction. Result: Sellers with good ratings stay on eBay, helping it keep its online auction share at 80%.

February 1996

SAFE HARBOR Following complaints about fraudulent buyers and sellers, the company sets up a Safe Harbor program that offers services such as fraud reimbursement and identity verification. Today, less than 0.01% of auctions involve fraud, vs. an average fraud rate of 0.09% for credit cards.

February 1998



what they sell or buy and at what price. This year, for instance, sales of discount products, from overstocked PCs to excess toasters and bedsheets, have rocketed. As the economy worsens, more and more corporations, from IBM to Walt Disney to Sears Roebuck, are turning to eBay as a place to unload mounting inventory. "The mix of products on the site changes by the minute as our highly entrepreneurial community of users adapts their own buying and selling strategies to trends in the economy," says Whitman.

eBay aims to press that advantage hard this season. It has just kicked off its first-ever holiday TV-ad campaign, which aims to show how shoppers can find almost anything on eBay. Produced by AOL Time Warner Inc., for which eBay is the exclusive auction partner, the ads also promote how easy it is for AOL members to find the perfect gift on eBay. eBay also is sending out catalogs in newspapers nationwide on Dec. 2 and opening a "Great Gifts" shop on its site, highlighting auctions of everything from gold necklaces to digital cameras.

For all its nonstop success, though, eBay faces a lot of challenges. Its \$60 stock price represents a nosebleed 2002 price-to-earnings ratio of 82, more than double

Microsoft's premium ratio of 31. The tiniest slip—or even, say, a few more anthrax-laden packages—could whack billions off its value overnight and limit the expansion opportunities that have in turn buoyed the stock.

Indeed, eBay is increasingly a victim of its own success. As Whitman moves to make eBay more of a clean, well-lighted place that attracts greater numbers of mainstream merchants and shoppers, she has riled existing customers who don't want more rules—or more rivals. These moves also pit eBay much more directly against bigger and more consumer-savvy behemoths. AOL Time Warner, Microsoft, Amazon, and Yahoo! are all trying to create online malls where people can buy just about anything from anyone.

Still, eBay has the Big Mo' right now, thanks to the groundwork laid way back on Labor Day weekend in 1995, when Omidyar unveiled a bare-bones site called Auction Web. Even then, the program-

mer and entrepreneur had much more in mind than simply helping his girlfriend trade Pez dispensers. He aimed to create a Nasdaq-like market for a wide range of goods, but with a twist. "I wanted to give the power of the market back to individuals, not just large corporations," says Omidyar. "It was letting the users take



On board: Ritz CEO Fred Lerner uses eBay technology on his company's site



BEYOND AUCTIONS eBay acquires Half.com Inc., which hosts sales of books and CDs at half-price or less. It's a first step toward satisfying sellers who want to charge fixed prices to appeal to more buyers. eBay's fixed-price sales have shot up to 16% of gross merchandise sales, from almost zero a year ago.

July 2000

HOUSE HUNTING A few months after noticing that sellers were listing homes for auction, eBay creates a real estate category. Although it still accounts for under 1% of eBay's overall sales, about 25 properties a day sell on eBay.



August 2000

OPEN FOR BUSINESS After a year of requests, eBay allows sellers to open storefronts on the site. eBay hopes this will prevent sellers from using eBay simply to drive buyers to their own Web sites. Some 30,000 merchants have signed up. In January, they will begin paying \$9.95 in monthly "rent."

July 2001

August 1999

NOTICING ON Noticing a one-month slump in several miscellaneous categories, eBay spots a surprising reason: too sales. So it creates a category for sales of used cars and car parts. eBay motors now accounts for 16% of the company's gross merchandise sales—an annual rate of \$1 billion.

August 2000

BACK TO SCHOOL After sellers clamor for training to improve their auctions, eBay offers classes. Called eBay University, the program has attracted more than 20,000 people in 19 cities. It's a great marketing tool as well: Within a month, these users double their activity on eBay.



January 2001

BUY IT NOW Several months after a seller suggested giving buyers a way to end auctions faster, eBay tries out a Buy It Now feature that allows buyers to stop the auction with a bid at a set price. Today, 40% of listings feature Buy It Now. That has helped close auctions in an average 6.1 days today, vs. 6.9 days at the end of 2000, so eBay gets paid faster.

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responsibility for building the community—even the building of the Web site.”

For instance, he would answer e-mails from buyers and sellers during the day, then rewrite the site's software that night to incorporate their suggestions, from fixing software bugs to creating new product categories. Says e-commerce expert John Hagel III, chief strategy officer with e-business incubator 12 Entrepreneur Inc.: “It really helped give people a sense of ownership and participation.” Likewise, Omidyar set up an online bulletin board for customers, whose volunteered help kept early support costs almost nil—and cemented their loyalty.

Omidyar's biggest breakthrough was the Feedback Forum, a rating system that allows buyers and sellers to grade each transaction positive, negative, or neutral. Amazingly, it works. More than 99% of feedbacks are positive (sample comment: “Great Bidder! AAAAA+++++ Highly Recommended!”). And eBay's rate of fraud remains below 0.01%. By contrast, credit card fraud runs at nine times that rate. And positive ratings, which translate to more sales, keep people from straying to other sites. Says Dwayne Rogers, who sells vintage fruit crate labels on eBay from his home in Chico, Calif.: “They just don't have any competition.”

But as eBay grew from a small town into a city, urban problems erupted, such as contraband goods. Since early 1998, eBay has used more stringent rules to crack down on crime, and banned sales of firearms. Indeed, eBay has increasingly realized that, like government in a democracy, it can't leave absolutely everything to the people. Says Jeff Jordan, senior vice-president in charge of eBay's U.S. operations: “You can't govern a metropolis the

Maynard Webb, who joined as president of eBay's technology unit, has upgraded systems so eBay's site is down less than 42 minutes a month despite much higher traffic. Credit that partly to Whitman, who dived into the technology despite her lack of experience in it. Still, eBay's customers had a big part, too. Shortly after Webb joined, he recalls, eBay's discussion boards twice lit up with user complaints about site glitches. His techies claimed nothing was amiss—and both times were proved wrong. “They catch things we don't,” Webb says of eBay's customers. “The community actually moves faster than we do.”

Sometimes, so do rivals. Yahoo and Amazon beat eBay on such features as online bill payment and uploading of product photos. Shmuel Gniwisch, CEO of online jewelry seller Ice.com, says Yahoo early on provided services more tailored to helping commercial companies. eBay admits it sometimes doesn't have the resources to do everything all its customers want—and, on occasion, just forgets to listen. Says Brian T. Burke, senior manager of community support: “Sometimes we're kind of slow.”

As befits a corporate democracy, eBay's biggest challenges are political. Features good for buyers, such as those e-mail auction referrals, can hurt sellers. Lately, sellers are especially peeved at eBay's promotion of large commercial companies such as Disney, which rates a special area in the Disneyana category. Says David Steiner, an eBay seller who's also president of the online auction watchdog site AuctionBytes.com: “The general consensus of veteran sellers is that they've forsaken the people who built them in favor of corporate sellers.” eBay argues that commercial sellers lend credibility to their categories, drawing more buyers to all the sellers—a point many merchants concede.

Yet others think eBay isn't listening as well as it once did to its core individual and small-business merchants. “They've gotten too big for their britches,” fumes Ron Saxton, an Apple Creek (Ohio) seller of die-cast cars. eBay didn't consult its customers when it launched its Auction for America campaign a week after the September 11 attacks, aiming to raise \$100 million in 100 days for victims. And eBay's insistence that sellers use its billing system, rather than let them accept checks or use



Loyal customer:
Dwayne Rogers
with the fruit
crate labels he
sells on eBay

a more popular rival system called PayPal, rubbed many the wrong way. That may partly explain why the charity drive has raised less than \$6 million halfway through—despite donations such as Jay Leno's celebrity-signed Harley-Davidson motorcycle, which sold for \$360,200.

Few complaining sellers, however, stop or even reduce selling on eBay, or go anywhere else. Partly, that's because eBay commands more than 80% of the online person-to-person auction market. “The only way I'm leaving eBay is kicking and screaming,” says longtime eBay collectibles seller Tina DeBarge. Sure, eBay's relationship with its customers can be messy, says eBay board member Scott Cook, chairman of financial software maker Intuit Inc., “but in the same way that democracy is messy compared with the straightforwardness of a dictatorship.”

“SHOELESS” JOE JACKSON'S “BLACK BETSY” BASEBALL BAT SOLD FOR \$578,000

same way you governed Mayberry.”

eBay's key public-works project: its computer network. Until last year, it was plagued with outages—including one in June, 1999, when eBay was completely shut down for 22 hours thanks to software problems and no backup systems. Former Gateway Inc. Chief Information Officer

TWO YEARS AFTER CREATING A SEPARATE eBAY MOTORS SITE, SALES OF AUTOS AND CAR PARTS TOP \$1 BILLION

It doesn't hurt that Whitman, despite her traditional top-down marketing background at Disney, FTD.com, and Stride Rite, became a convert to the eBay way shortly after she joined as CEO in early 1998. Indeed, she's a top seller among the company's 2,500 employees, with a positive feedback rating in the hundreds. In May, she auctioned some \$35,000 worth of furnishings in her ski condo in Colorado to understand the selling experience—and immediately required fellow execs to sell on eBay so they, too, can detect problems firsthand.

It's no surprise, then, that as eBay grew beyond its ability to address individual user concerns, Whitman has pushed it to devise a constant stream of new ways to tap the expertise of its customers en masse. Naturally, eBay harnesses the special qualities of the Internet to gather intelligence much deeper than most brick-and-mortar businesses can obtain. For instance, before eBay revamped its bread-and-butter collectibles categories earlier this year to make products easier to find, it first e-mailed 1.2 million customers asking them to check out the proposed structure. Of the 10,000 who responded, 95% of them had suggestions, and many were used.

Some of its most effective ways of getting user input, though, don't depend on the Net. Since early 1999, eBay has convened Voice of the Customer groups, flying in a new group of about 10 sellers and buyers from around the country to its San Jose (Calif.) headquarters every few months. Execs grill them on issues and ask for their views on new features and policies. "Some of the things we discussed led to changes," such as improving eBay's feedback policies, says Voices participant George Hawkins, who sells antiques and collectibles on eBay from Duncan, B.C.

The result: fewer problems with new features and policies, and fewer big blowups. Even when something does go wrong, eBay uses all that input to shift gears quickly. In the past three months, in fact, Whitman says eBay has deliberately started budgeting an extra 10% to new projects so it has the resources in place to make a quick turn. "They can essentially negotiate with 50,000 users at once and make it work," says Munjal Shah, CEO of the auction services firm Andale Inc.



Most of all, eBay simply watches—very carefully. Virtually all of its fastest-growing new categories, such as autos, grew out of its noticing seller activity and giving it a shove at the right moment. After noticing random car sales, eBay created a separate site called eBay Motors in 1999, with special features such as vehicle inspections and shipping. This year, eBay expects to gross some \$1 billion worth of autos and parts—many of them sold by dealers. "It's the way of the future," says Bradley Bonifacius, Internet manager at Dean Stallings Ford Inc. of Oak Ridge, Tenn., which has sold 50 cars on eBay in the past year.

Most intriguing, customers have been pushing eBay to move its e-commerce system outside the borders of its own Web site. Ritz Interactive, the online unit of Ritz Camera, for instance, is using the technology to run eBay auctions on its own site. Says Ritz CEO Fred H. Lerner: "eBay has very, very aggressive plans to create an e-commerce platform." Indeed, eBay is encouraging others to build software applications based on eBay technology—much as Microsoft does with its Windows operating system. A flourishing ecosystem of companies could enrich eBay's marketplace by providing support services such as listing tools, escrow, and bill payment. Essentially, says S.G. Cowen Securities Corp. analyst Scott Reamer, eBay aims to become the operating system for e-commerce: the preeminent place for people and businesses to sell online.

It's exciting new territory—and dangerous, too. For starters, a raft of rivals from Yahoo and AOL to Microsoft and Amazon aim to be the biggest places for e-commerce, too, and some are making fast progress. But there's a bigger question: Can eBay's values survive such grand ambitions? After all, trying to be the Microsoft of e-commerce doesn't sound, well, very eBaysian—which may be why Whitman frowns and demurs when people describe eBay's goal in such stark terms. For his part, Omidyar frets that the growing participation of large commercial sellers could dilute eBay's unique

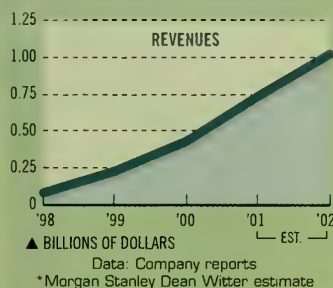
culture. "If we lose that, we've pretty much lost everything," he says. eBay's people power made building a business a breeze compared with everything conventional companies must do. Keeping in touch with all those millions of customers from here on out won't be so easy. **e**

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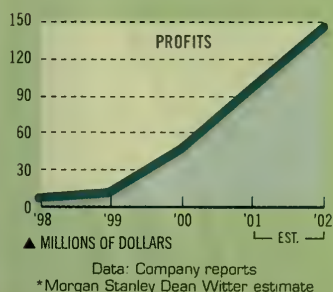
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eBay Shines In A Dark Economy

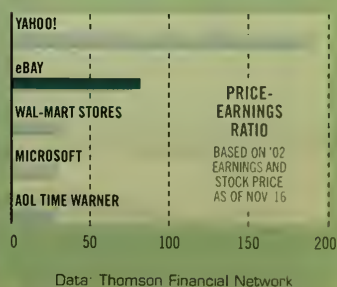
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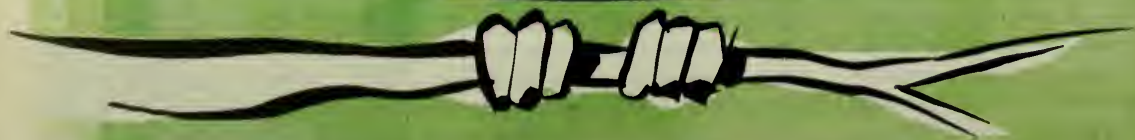


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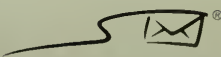


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The Year ^{of the} E-Piggyback

This holiday season, traditional retailers are using dot-coms dead and alive to serve their customers better

BY ARLENE WEINTRAUB

JUST BEFORE HALLOWEEN, KB Toys kicked off the fourth quarter in an appropriately spooky way: It raised eToys Inc. from the dead. After KB bought most of the bankrupt dot-com's assets for \$15 million last spring, the 1,300-store chain relaunched the site in October. By offering such popular eToys features as a gift

registry and sophisticated search engine, KB hopes to attract previous eToys customers who liked the Web site but didn't know it went bust. What's more, it got a state-of-the-art warehouse in Blairs, Va., and the right to send promotional e-mail to 3 million former eToys customers. At the same time, KB is keeping its own Web site so it can hang on to its original stable of customers. Now, KB expects to double its online sales this year, to \$80 million. "EToys was a first-class operation," says KB Chief Executive Michael L. Glazer. "We expect a lot of its customers to show up again."

This Christmas, traditional retailers are taking the lead online, but not all by themselves. They're riding on the backs of dot-coms—dead and alive. Blending in assets they bought for peanuts from failed e-tailers is only part of it. Many others are forming alliances with surviving dot-coms that would have been unthinkable a year ago. After losing \$29 million a year online, Borders Group Inc. linked up with rival Amazon.com Inc. to handle Borders' on-

line sales through a co-branded site—which turned profitable almost instantly after it was launched in August. Other retailers such as QVC, Modell's Sporting Goods, and Kmart have outsourced much of their online inventory and customer service operations to Web fulfillment companies such as Global Sports Inc.

NOBODY'S THINKING OF A WEB SITE AS A PATH TO QUICK IPO RICHES

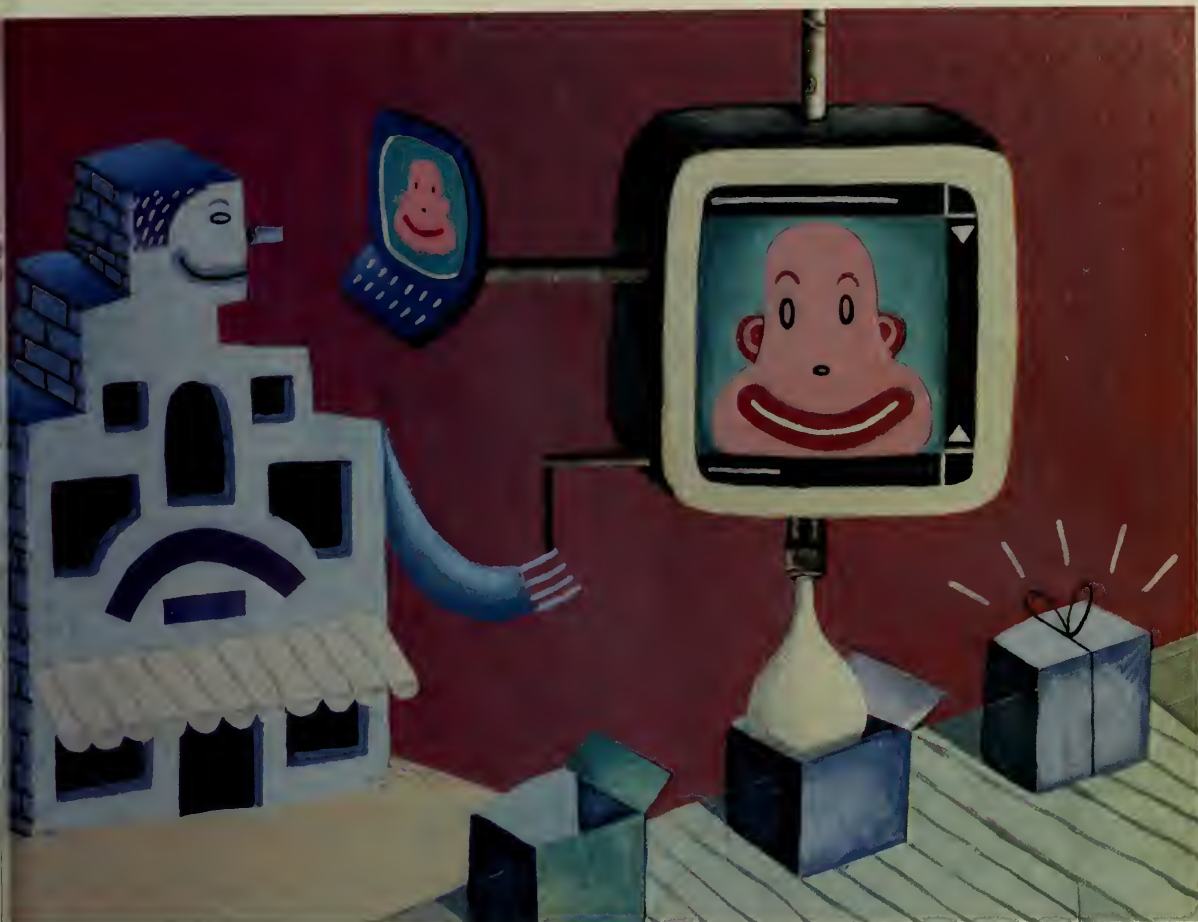
It all adds up to a massive rethinking by traditional retailers of their role online. Following the dot-com crash, many have chucked the idea of spending hundreds of millions to catch up with heavily funded but often doomed e-tailers. Instead, smart bricks-and-mortar retailers are focusing on what they do best—merchandising, marketing, and operating stores—while handing off much of the technical and logistical tasks of the online world to those with the know-how. And they're treating

their Web sites not as a fast route to initial public offering riches, but as another sales channel—one that, for the average retailer, generates only 2% or less of overall sales. "Online is important, but it's not core to our growth," says Bob Edington, director of online operations at Borders.

Indeed, retailers are using dot-coms past and present only partly to win new customers. They also hope to use Web sites to serve existing customers better and save money. After all, there won't be much growth online anyway this holiday season, thanks to the sagging economy. Jupiter Media Metrix Inc. expects online holiday sales to rise only 11%, to \$11.9

billion. That's why many retailers won't be doing much marketing of their online sites beyond including Web addresses in ads. "We used to hear retailers yelling about when they were going to take their Web sites public," says Jupiter analyst Ken Casar. "Now it's all about minimizing risk and keeping a low profile online."

Too low a profile could backfire, though, especially when consumer behavior is so volatile. In a recent poll of 3,000 consumers, market researcher Odyssey found that 54% of Web shoppers plan to buy online this season, down from 71% last year. "The Web is just as vulnerable to changes in the macro economy



as the rest of retailing is," says Sean Baenen, Odyssey's managing director. "Online retailers have to make sure they're getting the message out that people can still find good deals on the Web."

One way they're doing that is using the Web sites of once-independent upstarts to provide a better shopping environment. That's what Estée Lauder Co. did after it bought cosmetics e-tailer Gloss.com for an estimated \$5 million or less in April, 2000. It relaunched the Gloss.com site in October to market its own brands—plus those of Chanel and Clarins. The unusual collaboration among rivals, says Group President William P. Lauder, more closely mimics the choice a woman would find in a department store. Lauder's research found that 70% of women prefer to shop where there's a wide selection because, on average, they use seven brands of cosmetics. Says Lauder: "We danced beside our competitors for a long time anyway, so it was mutually beneficial to give our customers similar options online."

Even at bargain-basement prices, these resurrected sites are no slam-dunk money-makers. Because Lauder plans no dedicated marketing for Gloss.com this season, Banc of America Securities analyst William Steele says there's no evidence that it will attract enough buyers to pay for its upkeep. And the shoestring marketing means Lauder may make it tough to communicate the advantages of shopping for cosmetics online. Says Steele: "The jury's still out as to when they'll make money on this." It's the same with KB Toys: Despite the sales boost it expects from eToys.com, KB could still lose money on the Web this year because, so far, traffic to the resurrected site is limited.

Such uncertainties are the reason many retailers are taking yet another tack. They're leaving Web work to the experts by outsourcing various operations to surviving dot-coms and fulfillment outfits. Toys 'R' Us Inc., for instance, signed a deal with Amazon.com to take over operation of the Toysrus.com site, as well as shipping of everything from Razor scoot-

ers to Furbies. One benefit: The highly publicized late shipments that plagued Toys 'R' Us online in 1999 have vanished. Its Web sales are now expected to shoot from \$180 million in 2000 to \$300 million this year, says investment bank Gerard Klauer Mattison & Co.

Retailers get other benefits from the dot-coms as well. For all their faults, e-tailers have spent years and millions of dollars perfecting features that retailers now admit are valuable to consumers. "We can now offer product recommendations and reviews, and we can ease the experience of buying online, which ultimately will make people more likely to buy there," says John Barbour, CEO of Toysrus.com. Its success prompted Circuit City Stores Inc. and Target Corp., among others, to strike similar deals with Amazon.

Most of all, retailers get the attention of Amazon's 38 million customers. "The reality is, they have a lot more traffic," says Target Vice-Chairman Gerald Storch. (Amazon is the 12th-most-visited site on

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STRATEGIES

the Web, while Target doesn't make the top 50.) Although retailers pay Amazon about 10% to 20% of sales through Amazon's site, they get far more business—and avoid having to spend mil-

investment, and we went from having 60 full-time Internet people to one," says Dick's Chief Operating Officer Bill Colombo. "We can take that capital and invest it in opening new stores."

MANY RETAILERS ARE OUTSOURCING THEIR E-BUSINESS

lions of dollars on their own Web site and warehouses.

Some retailers find the advantages of outsourcing so compelling they're giving up a bigger cut in return for washing their hands of the whole online rigmorale. In April, Dick's Sporting Goods Inc. signed on with Global Sports, which not only handles site design, fulfillment, and customer service, but also owns and manages all the inventory. On average, Global Sports takes 90% or more of its clients' online revenues, but what Dick's nets is almost pure profit. "We make no capital

Striking the right balance of frugality and visibility online won't be easy. The problem is figuring out how much to spend when there's no way to predict what's really going to happen. The Web, after all, has never lived through a war, bioterrorism, or a recession, and now they're all happening at once. One thing's for sure: Retailers will need as much help as they can get—even from the dot-coms that once sought to put them out of business.

Contributing: Heather Green in New York, Robert D. Hof in San Mateo, Calif., and Faith Keenan in Pittsfield, Mass.

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For a Q&A with John Barbour, CEO of Toysrus.com, visit ebiz.businessweek.com.

Bricks Tap Clicks for a Holiday Fix

This season, traditional retailers are beefing up their e-commerce efforts by allying with surviving e-tailers, hiring online fulfillment specialists, and even bringing dead dot-coms back to life.

Borders Group

What's new: Borders hired Amazon to operate a revamped, co-branded Borders.com Web site, as well as handle shipping and customer service. **Result:** Selling out to the competition? Maybe, but Borders was losing \$29 million a year online before. Now its site, opened in August, is profitable.

Dick's Sporting Goods

What's new: In April, the 125-store Eastern retail chain outsourced its DicksSportingGoods.com site to Web company Global Sports, which manages the site, inventory, and customer service. **Result:** Even though Global Sports now gets most of the site's revenues, Dick's' remaining share is pure profit because it was able to cut its Net staff from 60 to one. Now, it has shifted the money toward opening 20 new stores while maintaining an online presence.

KB Holdings

What's new: In October, the owner of the 1,300-store KB Toys chain resurrected eToys' Web site after buying most of the bankrupt dot-com's assets for \$15 million. **Result:** Having lost \$100 million on its own site while netting only 1 million customers, KB spent far less to grab a first-class warehouse, a snazzy Web site, and the right to e-mail eToys' 3 million previous customers. Now it hopes to double its online sales this year, to \$80 million.

Data: Company reports, BusinessWeek

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When Oil Gets Connected

BP's Net ventures will save \$300 million this year—just as times turn tight

BY WILLIAM ECHIKSON

ON A FRIGID winter day last year off the coast of Norway, a BP PLC exploration geologist discovered a more efficient way to find oil on the dangerous Atlantic seabed. The secret: By changing the position of the drill heads, he was able to better aim the equipment and reduce the number of misses. The Norwegian employee posted a de-

scription of the new process on the oil giant's intranet for everyone in the company to see. Within 24 hours, an engineer working on a BP well near tropical Trinidad saw the posting and e-mailed asking for details. After a quick exchange of messages, the Caribbean team was able to save five days of drilling—and \$600,000.

Oil is a dirty, greasy business that requires lots of sweat and muscle, but it is being overhauled by the Web. BP, with \$150 billion in annual sales, has 100,000 employees working in some 100 coun-

tries. The Net helps the London-based company knit together those disparate operations and turn its global scale to its advantage. Along the way, the Internet has helped BP save \$300 million this year and boost innovation at every step from exploration to running gas stations. "The Net allows us to stop being a conglomerate and become a single, smooth global corporation," says John Leggate, BP's group vice-president for digital business.

These days, that's more important than ever. Since September 11, demand for en-



Leggate is using the Web to unify the oil giant

ergy has plummeted and oil prices have fallen by a third—cutting into oil company profits. On Nov. 6, BP said third-quarter earnings fell 20%, to \$3 billion, even as oil and gas production rose 3%. BP's Web efforts, however, lessened the pain: Savings and added revenues from Net ventures reached some \$75 million in the quarter. And with the world economy heading for a recession, BP will need all the help it can get. "The value of every penny saved is becoming clearer," says Leggate.

BP isn't the only global oil giant shifting to the Net, but it's moving the quickest. As the Norwegian-Caribbean drilling exchange illustrates, it already has made sharing knowledge online a central part of its culture. And it has a reputation for being nimble in comparison to its competitors. "Shell and Exxon still act like they're run by committees, while BP is fast on its feet," says oil analyst Steve Turner of Commerzbank in London.

DREAMS VS. REALITY To be sure, those who dash ahead sometimes push too hard. A year ago, BP said it hoped to move 95% of its \$25 billion in procurement to the Web in 2001. That target was unrealistic. The company will manage to complete just 4% of its purchases online this year, resulting in savings of some \$100 million. The assumption that BP could save money on everything it buys by shifting purchases to the Web proved false. "We could buy coffee cups online, but when we looked closely, who would care?" says Mark Stanke, BP's vice-president for

global e-procurement. He says it will take several more years before even half of BP's purchasing takes place online.

Then again, what company isn't finding that virtual dreams collide with real-world realities? A step forward often means taking a half-step back to evaluate whether you're still heading in the direction you want. Consider BP's attempt to transform the corner gas station into an

“The value of every penny saved is becoming clearer”

online retail center. Last year, it launched a \$200 million plan to install Web links at gas pumps and Net-linked kiosks inside stations. But at a test facility in London, only about 10% of customers use the service. And many are dismissive of it. "I wish they would just get this bloody pump to work and not worry about the Internet," says painter Patrick Burke, as he struggles to fill his tank.

More than outright failure, BP's missteps reflect a hard-driving, risk-taking corporate ethos. In 1998, BP sparked oil industry consolidation when it announced a merger with Amoco. The next year, it bought Atlantic Richfield. And in 2000, it took over Burmah Castrol. The Web has played a key role in helping BP digest the acquisitions. On Jan. 1, 1999, shortly before the Amoco deal closed, Leggate was named the company's digital director. His first task: integrating the two companies' computer systems so all employees could

have access to the same data. "When the merger went live, it was crucial that everybody across the world could speak to each other online," says Leggate.

It was a new world for Leggate, who trained as an engineer and worked in nuclear power before joining BP. When he was offered the job as Net chief, Leggate was in Azerbaijan, negotiating a pipeline across the Caucasus Mountains—a politically charged project on which the latest James Bond film, *The World Is Not Enough*, is loosely based. "I felt like I was in a Bond movie, except I didn't get the girl," Leggate jokes in his staccato Scottish accent. Since stepping into BP's top tech job, Leggate has become a technology evangelist: He requires subordinates to submit reports electronically, and his central London home boasts a computer server in the basement managing a network that he and his four teenagers use to share files and get online.

'SHINY BRAIN' Although his new job appeared less swashbuckling than his Azerbaijani adventures, Leggate infused it with Bond-like flair. He cut through the tangle

of systems BP had inherited in the mergers and slashed overlapping tech projects. Leggate produced \$500 million in savings in 11 months—less than half the time the company had given him to cut costs. That success, plus his shaved head and quick mind, prompted colleagues to dub him "Shiny Brain." And his focus and drive have given him a reputation for being a taskmaster. "Send John an e-mail at midnight and he responds the same evening," says e-procurement chief Stanke.

After trimming fat for a year, Leggate began using the Web to build muscle. Last year, he spent \$250 million on initiatives aimed at getting the company online. He gave Net-linked laptops to two-thirds of full-time employees—everyone from top management to roughnecks working on oil rigs. And he constructed a Web-based employee directory called Connect. This corporate Who's Who contains personal home pages for virtually every

employee. BP workers searching for information about drilling in the Caspian Sea, for example, might land on Joshua Turner's page. While they're there, they'll discover details about Turner's work as a geologist as well as his love of sailing and squash—a potential ice-breaker that helps create a more personal bond between employees thousands of miles from one another. "A common way of communicating creates a common culture," Leggate says.

Such simple ideas are a powerful tool in a global company created from takeovers. One sign of success: The number of hits on BP's intranet has more than doubled in the past 11 months. That's leading to a growing payoff. South African marketing manager Fumu Mondoloka, for instance, needed to prepare an offer to supply fuel and lubricants to a new South African Breweries PLC facility. He searched on Connect for other BP employees who had experience with the beverage industry, locating the terms of an offer made to a Scottish beer maker. "The process yielded an incredible spiral of help," says Mon-

doloka, who got the brewery contract.

BP also is wielding Web technology to reinvent its most basic business—finding oil. Drilling for crude traditionally was an expensive, hit-or-miss affair, requiring battalions of rig builders and engineers airlifted into far-flung sites. Now, before a

major well is started, teams gather in any of 15 3-D imaging rooms from Anchorage, Alaska, to Aberdeen, Scotland. There, geologists and engineers tap into data sent over the Net that allows them to view images of the far-off Caspian seabed or deep below the Canadian Rockies. "Decisions on where to drill that often took us weeks now can be made in hours," says Mike Saunders, a project coordinator. Better yet, the supercomputer images can help BP avoid brutally expensive mistakes such as dry holes. Saunders says BP saved some \$45 million on one drilling project

in the Gulf of Mexico alone, and the company expects savings of \$150 million annually from the program.

BP has made big strides in bringing its global organization online, demonstrating that the Net can transform even the heaviest of old-line industries. But

“It was crucial that everybody ... could speak to each other”

this transformation won't take place overnight. And in its enthusiasm to embrace the Web, BP has sometimes stumbled or overreached. "We still have a long journey ahead," Leggate admits. It will take patience, concentration, and much more hard work for the Internet to reach its full potential and produce a steady stream of gushers for BP. **e**

e.bizonline

For a Q&A with BP e-biz chief John Leggate, visit ebiz.businessweek.com.

On the Web from Well to Wheel

BP is using the Net to boost efficiency, saving \$300 million this year alone. Here's how:



FINDING CRUDE: Instead of sending teams to far-off exploration targets, BP scientists now gather in any of 15 data centers around the globe to view 3-D images of drilling sites sent over the Web. **Payoff:** Up to \$150 million in annual savings.



GOING PLACES: Helicopters shuttling between Scotland and North Sea oil platforms often fly with empty seats. So BP launched heliseat.com, an online system for sharing the seats with other oil companies. **Payoff:** Up to \$5 million in new revenues.



BUYING GEAR: BP's divisions used to bid separately for everything from hard hats to drill bits. This year BP will buy 4% of its \$25 billion in purchases online. **Payoff:** \$100 million in savings this year by identifying low-cost suppliers.



GETTING SMARTER: All employees have personalized Web pages listing their areas of expertise. This helps managers tap into BP's reservoir of knowledge. **Payoff:** In one case, engineers in the Caribbean saved \$600,000 by adopting a drilling process developed in Norway just days earlier.



SERVING STAFFERS: Human-resources data such as salary and pension payments have been put online. Calculating relocation benefits, for example, once took weeks. Now, it's done online in seconds. **Payoff:** \$100 million in annual savings.



SELLING STUFF: BP is spending \$200 million to link service stations to the Net. Web-linked gas pumps let drivers check traffic. Inside, customers can—for a fee—read e-mail and surf the Web at Net kiosks. **Payoff:** BP hopes this will help generate half of its retail sales from goods other than fuel within five years, up from 20% of \$2.6 billion last year.

Data: BP, *BusinessWeek*

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BY JOAN O'C. HAMILTON

joan_hamilton@ebiz.businessweek.com

Happily Ever After?

Miss Nuptials on why a HP-Compaq union isn't the wedding of the year

DEAR MISS NUPTIALS,

On the eve of my wedding, I'm getting the funny feeling that not everyone is totally supportive. My shareholders have withdrawn several billion from my stock trousseau. Cousin Walter Hewlett is fussing. Some customers say they won't buy our products until they're sure the marriage will work. My employees just can't seem to get past the fact that thousands of them will lose their jobs—I mean does everything always have to be about them? Ironically, my competitors Sun Microsystems CEO Scott McNealy and Dell Computer Founder Michael Dell have been super-supportive. Miss Nuptials, am I just being too sensitive?

SIGNED, CARLY FIORINA

DEAR CARLY,

Somehow, ever since that press conference where you and Compaq Computer Inc. CEO Michael D. Capellas put on that Very Brady Bunch engagement party, I knew I'd be hearing from you. Alas, the days are past when an indefatigable blonde lady in an excellent pantsuit can proclaim her optimism for merging two dysfunctional families into one big happy one and be taken seriously. I must confess that, when I heard that loud crash, I thought the Brady's dog Tiger had gotten loose and was dragging Alice the housekeeper around—but I guess it was just the sound of all that market value being vaporized.

I hate to break it to you, Carly, but Las Vegas oddsmakers believe that it's more likely Osama bin Laden will give the commencement address at Sarah Lawrence next June than that anything good will come of the Hewlett-Packard/Compaq marriage. The stats on tech mergers are worse than the divorce rate. The majority of mergers lose value for shareholders. Have you never heard of AT&T and NCR? Burroughs and UNIVAC? Just ask Mr. Capellas about Compaq's ill-considered elopement with DEC. I know he assured you that it meant nothing (men!)—but there's a lesson there.

Miss Nuptials knows that you are frustrated, but I was startled by that e-mail you sent HP employees defending the merger and reminding them "until your manager tells you otherwise, stay focused." Miss Nuptials wonders if "otherwise" might have sound-



ed a bit like "until you're asked to pack up and march briskly to the parking lot."

On the bright side, I applaud your moxie in forging a truly modern alliance what with Compaq agreeing to take your name and all. But really, isn't it time you cleaned up your own company before you start slathering other people's problems or it like frosting on a seven-layer cake? Miss Nuptials always urges families to respect the bride's choices, but announcing that you were "not surprised" when the founding families of HP came out against this hookup was a blast of snippishness unbecoming a well-compensated CEO. After all, we have come to that part of the ceremony where people with a few billion on the line don't have to hold their peace.

The heat is on, and no doubt wedding planners at Wilsons Goodrich & Rosati and Goldman Sachs are busy spritzing you with Optimism and Eau de Synergy. However, we have checked with Miss Manners on this and declare that backing out might still be the better course. It's not like anyone but Michael Dell and Scott McNealy have sent gifts, and I hardly think those silver goblets engraved with "1+1=2" were in good taste. What's a few caterers' deposits compared with marching a once-great company down the aisle and into a sinkhole? Miss Nuptials' advice: Bow out, check into a spa for a refreshing makeover, and peruse the ample literature on co-dependency—in your case starting with *CEOs Who Merge Too Much*.

SIGNED, MISS NUPTIAL



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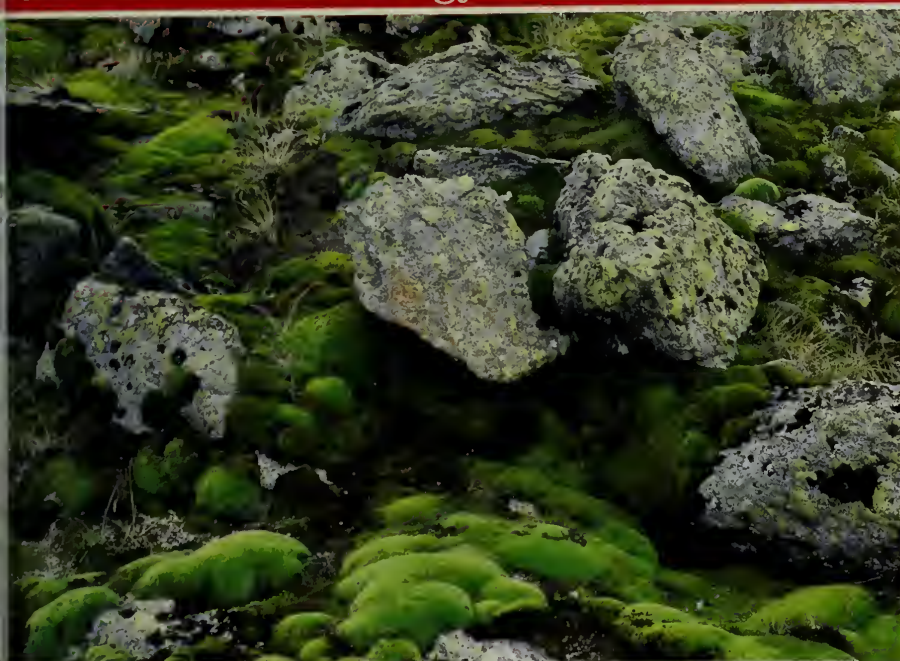


- 1 This is the **FOREMAN**
- 2 That placed the **Order**
- 3 That went through the **Dealer**
- 4 That notified **Contracts**
- 5 That alerted **Manufacturing**
- 6 That checked with **Accounting**
- 7 That contacted **Shipping**
- 8 That sent the **Delivery**
- 9 That sealed the **Process**
- 10 That lives in the **Integration Software**
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SOIL PROSPECTING

By analyzing DNA in soil, plant pathologist Handelsman (right) found a vast profusion of organisms that could not be grown in the lab

MICROBIOLOGY

DOWN IN THE DIRT WONDERS BECKON

Soil and sea yield unknown lodes of useful microbes

For more than a decade, Jo Handelsman had tantalizing glimpses of an elusive microscopic world she could not enter. When she put samples of soil under the microscope, she saw countless species of organisms she couldn't identify. But efforts to isolate and grow these microbes in the lab failed, and she couldn't learn much about them. Except for one thing: Genetic and statistical analyses revealed that these unknown organisms must make up 9.9% of all the microbes in the soil. One gram of soil—the weight of a little packet of low-calorie sweetener—can contain as many as 10,000 species unknown to science, says Handelsman, a professor of plant pathology at the University of Wisconsin.

Now, for the first time, she and her colleagues, along with several other research groups working independently, are learning to extract the DNA of these mysterious creatures and clone it. They are finding that the microbes differ so

profoundly from known bacteria that they could represent entirely new kingdoms of life—as different from other bacteria as animals are from plants. That means that the proteins produced by these creatures could have properties unlike any other such substances known.

Most current antibiotics come from microbes in the soil. They include streptomycin, the first treatment for tuberculosis, and vancomycin, currently the drug of last resort for the toughest infections. By now, however, conventional bacteria have been largely “mined out”: Most of their useful properties have already been exploited. Researchers say that studies of the palette of novel biological agents Handelsman and others are discovering could lead to a new wave of medicines, anticancer drugs, insecticides and industrial enzymes, many radically different from those already in use.

The research builds on earlier studies of exotic microbes that live in boiling

pools in Yellowstone National Park, at steaming volcanic vents on the sea floor, and in other forbidding locales. These so-called extremophiles—named for their affinity for extreme environments—were crucial in the development of one of molecular biology's most useful tools, a method of extracting and studying DNA called polymerase chain reaction, or PCR.

In a report in mid-November at the annual New Horizons in Science briefing in Tempe, Ariz., Handelsman said she and her colleagues at Wisconsin have already identified several new antibiotics from soil microbes, at least one of which is also proving to be a powerful pesticide. And in California, Edward F. DeLong and his colleagues at the Monterey Bay Aquarium have found a distinctive light-sensitive protein that could have applications in optical computers. They expect these to be only the first of many more such discoveries from a field of research known as metagenomics, or environmental genomics.

DAZZLING VARIETY. The field has led, among other things, to a new view of biological diversity. The dazzling variety of tropical rainforests, it turns out, is dwarfed by the unseen diversity in the microbial world. To take one example, a single gram of sediment on the ocean floor contains 1 billion organisms, says one of the field's pioneers, biologist Norman R. Pace of the University of Colorado. Dig down about one-third of a mile to an even more forbidding environment, and the sediment still contains about 10 million microbes per gram. The microbes in that 500-meter-thick layer of

ocean floor make up 10% to 20% of all the biological matter on earth, Pace says. They include uncounted numbers of species unknown to science.

Even human intestines—an environment most people consider pretty familiar—are home to perhaps 10,000 kinds of microbes. “I’ve been blown away by the diversity there,” says Pace, whose work was recognized in October with a MacArthur Foundation Fellowship. Indeed, one of the surprises in the decoding of the human genome was that it contains more than 200 genes that come from bacteria. Microbes not only keep us alive; in some small part, we are made of them.

Pace is looking at how these largely unknown microbes might play a role in Crohn’s disease, an inflammation of the small intestine. He has found that the makeup of the mixed “community” of microbes in the intestines changes in people with the disease. A similar thing might happen with tuberculosis, Pace says, leading him to wonder whether some diseases might be caused not by a single dangerous microbe but by a change in the microbial community—an ecological imbalance inside the human body.

Handelsman and Michelle R. Rondon, formerly of the University of Wisconsin and now at Ohio State University, have done most of their work with soil obtained from a University of Wisconsin research station 15 minutes from their lab. They devised a technique for isolating long pieces of DNA from soil, something that other researchers had assured them could not be done. Because soil is full of contaminants that can interfere with the finicky chemicals used to isolate DNA, it was a trial-and-error process—and in the beginning, it was mostly error. Rondon’s persistence paid off, however, and the researchers learned to extract strings of DNA from soil long enough to contain 50 to 80 genes. Some of this DNA came from known organisms, of course, but most of it came from the vast profusion of unknown organisms that couldn’t be grown in the lab. “This sent shivers down our spines, because it was the first glimpse we had of the uncultured world,” Handelsman says.

One of her primary interests is the development of new antibiotics, and her earlier work has already led to several new candidates. One of them, called Zwittermixin A, is effective not only against bacteria but also against gypsy moth caterpillars. When used in combination with Bt toxin, one of the most widely used pesticides for gypsy moths, it greatly enhances Bt’s effect.

Handelsman suspected that Zwittermixin A might alter the way Bt is handled in the digestive system of the caterpillars, making it more lethal. To find out, she turned her DNA extraction

techniques on the microbes in the gut of the caterpillars—where she was surprised to discover 36 kinds of bacteria more than two-thirds of which had not been seen before and many of which may be markedly different from known bacteria. The search for an answer has led to a batch of new questions.

WAVELENGTHS. The development of new antibiotics is also the aim of Julian Davies, a microbiologist at Cubist Pharmaceuticals Inc. and at the University of British Columbia. He is pursuing a different set of organisms that are also difficult to study: lichens. “Most of them will not grow in the lab,” he says. “The way to get at them is to get at their genes.” Davies and his colleagues have been able to extract many antibiotic-related genes from lichens. Like Handelsman, he is working with strings of DNA long enough to contain the complete set of genes that may be needed to manufacture an antibiotic—the whole antibiotic pathway, as researchers say. “I think we’re a long way from finding the next superdrug from this approach,” he says. But lichens “make a lot of interesting biologically active compounds.”

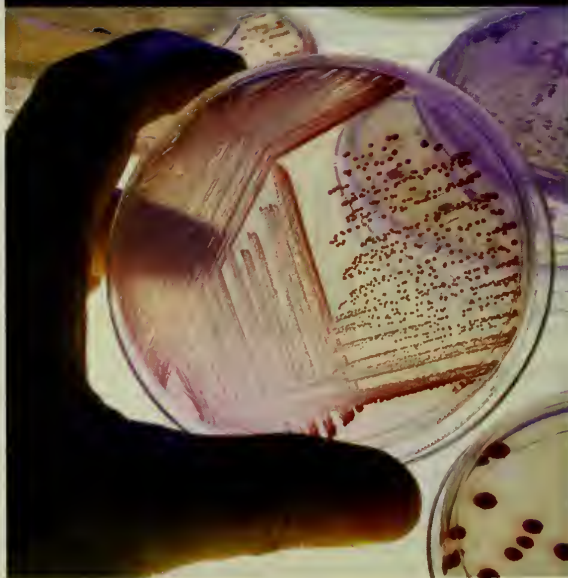
DeLong and his colleagues have done similar DNA extraction using seawater samples from Monterey Bay. One of the first discoveries was that organisms near the surface of the sea carry proteins that can use sunlight to make energy. Plants do that through photosynthesis, but this alternate system was unknown. Furthermore, the researchers discovered that microbes at different depths responded to different wavelengths of light—corresponding to the changes in the color of sunlight as it penetrates deeper into the ocean and is partly absorbed. The proteins’ light-sensing ability could make them useful in the construction of optical computer memory, DeLong says.

Handelsman, DeLong, and the others are confident the research will lead to new medicines and other useful products. But part of their excitement is the exploration of a new world as mysterious, alien, and beginning as the surface of Mars—although a lot easier to get to.

*By Paul Raelin
in Tempe, Arizona*

MINING MICROBES

Researchers are tapping a hitherto unknown world of microbes—a kind of parallel biological universe—that holds promise as a source of new antibiotics, cancer drugs, and industrial chemicals unlike anything seen before. Here is how they do it:



■ A sample is taken from soil, seawater, a boiling undersea volcanic vent, or another locale

■ Instead of searching for whole microbes, scientists extract DNA directly from the samples

■ Sophisticated genetic techniques are used to preserve long strings of DNA containing 50 or more genes

■ The DNA samples, many from unknown species, are cloned to produce proteins from the unknown microbes

■ These proteins are then screened to see whether they are potentially useful as drugs or industrial chemicals

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TEN POUNDS OF TECHNOLOGY: IN A ONE-POUND SACK?

When Europe's 3G networks are finished, the phones may not be ready

They were machines to die for. As prototypes for third-generation mobile phones emerged in the late 1990s, the only question was whose phone would be coolest. These handsets would not only handle e-mail, snap pictures, and send spreadsheets, they would videoconference and download music faster than they could play it. Sure, the telcos were taking on risk by spending billions on new high-speed mobile networks. But once customers got their hands on these irresistible handsets, the nascent industry would soar, right?

Not exactly. In fact, instead of energizing the mobile Internet, the new handsets may slow it down. Europe's phone companies are facing the possibility that when they finish their costly networks, within the next 12 to 18 months, the handsets may not be ready. Chances are, those that emerge will be far simpler machines than the dreamy *fin-de-siècle* prototypes. What's more, the manufacturers are struggling even to ensure that the new handsets will be able to communicate with each other.

MOVING TARGET. Why the alarm? Quite simply, the entire telecom industry is wrestling with a technology bear. The 3G handsets, on which Europe has wagered much of its tech future, are by far the most complex consumer electronics devices ever designed. To succeed, they must combine the wealth of applications available on a computer with the roving versatility of a mobile phone. The trick is to wedge all of this into a sleek little machine equipped with multiple radio bands and days and days of battery life—and it must sell at an affordable price. If that weren't enough, dependable handsets must be available in as little as a year, when the networks will start going live in Europe.

The pressure to come up with 3G handsets in a hurry is pushing much of the industry, from Finland's Nokia Corp. to Japan's NTT DoCoMo, to join forces. They all see just what a rocky road they're traveling. In Lund, Sweden, engineers at Ericsson have been working on the technology since 1993. Each year it gets harder. Why? Nearly a decade ago, customers would have gladly put up with a computer-phone the size of a ham hock and the most

in Lund. "If this happens, we'll see people do all sorts of new things in wireless."

Easier said than done. Traditionally, cellular phones have specialized in one kind of data: voice. The new handsets must be able to juggle music, video, and e-mail, as well as voice. This is a task the desktop computer is ill-equipped for, yet 3G phones must do it on the run, bouncing radio signals from one base station to another. And unlike the PC, which can take a few seconds to digest difficult assignments, a 3G handset must establish firm priorities: For instance, while it can let graphics for an online horoscope dribble in slowly, voice traffic must be instantaneous.

Then there's the question of size. "If it doesn't fit into a pocket," says Bill Bauer, director of access at Palm Computing, "people won't carry it around." But to communicate with new phones and old, the 3G handsets must run on at least three radio bands. That consumes space and juice. The computer-like applications require plenty of power, too.

Like any startup technology, the first 3G phones will likely be hefty, with a price tag to match. Full-featured devices "will be like bricks," warns Kramran Kordi, 3G business development manager of Ubiquitous Ltd., a Cambridge (England) test-equipment company. And prices will likely hover at \$1,000. Experts predict it will take at

THE 3G CHALLENGE

Complexity The new generation of phones will have to communicate with the previous generation. This means equipping 3G handsets with at least three different radio bands, as well as a computer. In addition, users are likely to demand extended battery life, plus a machine that slides discreetly into a pocket.

Crashes When cell-phone users move, the network passes their call from one transmission tower to another. Picture a 3G user talking and Web surfing on the same handset—while riding a high-speed train. With two streams of data bouncing from tower to tower, only precision engineering will prevent wireless crashathons.

Errors A cable transmits clean data, with only one error per billion bits. Wireless, in contrast, is filthy, with errors occurring 10 million times more often. Flexible wireless systems must reinterpret faulty data and know when to ignore them.

Data: BusinessWeek

rudimentary e-mail service. Now, they aren't likely to make concessions. The new handsets must be an e-mail machine as slick as the BlackBerry, as well as an organizer that can match the Palm or Microsoft Corp.'s Pocket PCs. And all these applications must work seamlessly with a state-of-the-art phone. "It has to work every time, it has to be quick," says Tord Wingren, president of Ericsson mobile platforms



least three years and a couple of generations of 3G phones before developers can ferret out the crucial applications and bake them onto mass-produced silicon chips. That will help drive down costs and power consumption.

Engineers at Ericsson's lab in Lund and elsewhere must deal with an even thornier problem. Compared to a standard computer connection, a mobile hookup is full of digital dirt: There's 1 error for every 100 bits, as opposed to 1 in a billion for cable. Software in the handset must be able to interpret these errors, masking some and sending out queries to iron out others.

As a result of these limitations, many of the early 3G handsets may be specialized machines. For a taste of what is to come, take a look at Nokia's new 5510 phone. Pitched at kids, the de-

Perfecting the handsets—which must have the power of a PC and fit in a shirt pocket—will result in the world's most complex consumer electronic device

vice offers none of the power-hungry business tools adults crave but instead focuses on voice, messaging, and music playbacks. Meanwhile, the Sony-Ericsson joint venture is hurrying to put together 3G devices outfitted for video games, a segment that's the rage in Japan.

GROUNDBREAKER. In fact, Japan is proving to be a major laboratory for the industry. Market leader DoCoMo launched a service based on a preliminary 3G standard in October. Japanese manufacturers also are far ahead in color screens, miniaturization, and power management. And the job's easier in Japan because DoCoMo's phones only have to communicate with one network. This frees the Japanese—for now—from a big headache facing the rest of the world: getting the handsets to work with multiple networks and standards. Indeed, it's the continual testing that has slowed down the rollout of 2.5G. This intermediate mobile wireless system has just debuted in Europe, a full year behind schedule.

To cut down on 3G delays, the industry is banding together. In recent months, a host of manufacturers have moved to license their long-secret standards. And on Nov. 12, industry leader Nokia—which previously appeared determined to go it alone—announced plans to license its own 3G software. Two days later, in Tokyo, Nokia Chairman Jorma Ollila and DoCoMo President Keiji Tachikawa unveiled plans to work together on an open architecture. The key holdout for now is Microsoft, which is pushing its own Windows software for the mobile Internet.

With most industry leaders getting behind open global standards, the need for exhaustive testing may diminish. That should pave the way for quicker releases and perhaps a broader offering of handsets. Still, Kordi, for one, believes 3G won't start to reach industrial scale—and lower prices—until 2004. By then he sees consumers buying 30 million 3G machines annually, which amounts to only about 8% of this year's global handset sales.

The frantic race for 3G could provide an extra payoff. If the phonemakers manage to come up with tiny computers that meet high standards of speed, size, reliability, and power consumption, they'll be positioned as powers not only in 3G but in the broader world of computing. Let's not get ahead of ourselves, though. The task now is to put together miracle machines in a hurry for a wireless industry that's bet the ranch on 3G.

By Stephen Baker in Lund, Sweden

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Developments to Watch

EDITED BY CATHERINE ARNST

NANOCOMPUTERS THAT DON'T NEED HUMAN HELP

THINK OF A DNA MOLECULE as software. Think of enzymes that work on DNA as bits of hardware. Put bits of DNA and enzymes in a test tube, and you have 1 billion primitive computers, all working in parallel in a single drop of water at a billion operations per second with 99.8% accuracy. In the Nov. 22 issue of

Nature, Israeli scientists at the Weizmann Institute of Science and Technion Israel Institute of Technology say they have built such a biological computing machine. It takes bits of DNA as inputs and manipulates them to produce outputs. The scientists theorize that it can execute 765 different programs—although nothing as complex as, say, a spellchecker. For example, one program the team got to work looks at a string of zeroes and ones and determines if it contains

an even number of ones.

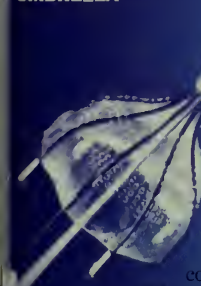
DNA computing has been a hot research area since the mid-1990s. But Weizmann project leader Ehud Shapiro says his team has made an important advance in setting up the DNA “software” so that the computer works without human intervention. He sees the device as a step toward more sophisticated nanocomputers that could reside in the body, detect chemical abnormalities, then synthesize and release drugs to fix them. *Peter Coy*

INNOVATIONS

■ Money may not buy happiness, but it could buy memories. Kristy Nielson, an assistant professor of psychology at Marquette University, reported at a recent neuroscience meeting that she had three groups of people memorize 30 words. The subjects were tested for recall immediately afterward, and all performed about the same. But before they left, the researchers praised one group, did nothing for the second, and gave each person in the third group a dollar. When the subjects returned a week later, those who had been paid did much better at recalling the words than the members of the other two groups. Those who were praised, however, did only slightly better than the group that received no reward at all. “Financial reward produces significantly better results than social reinforcement,” Nielson concluded. That’s something for employers to keep in mind when considering whether to give raises at annual review time.

■ Further incentive to eat your broccoli: An Agriculture Dept. lab has developed a strain of the vegetable enriched with an anti-cancer agent, selenium, that appears to do a better job of protecting rats from tumors than standard forms of the dietary supplement. Researchers at Roswell Park Cancer Institute in Buffalo said that broccoli seems to store selenium in a unique form that is easy for the body to metabolize. One group of rats injected with cancer cells was given the enriched broccoli—which is not commercially available—while another was given the equivalent amount of selenium in supplements. The rats given broccoli developed far fewer mammary and colon tumors and pre-cancerous lesions than the groups given supplements.

THE ANGIOGUARD OPENS LIKE AN UMBRELLA



A DRAGNET FOR DEBRIS IN ARTERIES

ANGIOPLASTY IS A POPULAR PROCEDURE FOR CLEARING clogged arteries and veins, but it can also be risky. When the balloon and catheter pass through the artery, they can dislodge bits of clotted blood and tissue, called emboli, that may enter the blood and clog another artery. To solve this problem, Johnson & Johnson subsidiary Cordis has developed a tiny trap for the emboli called AngioGuard.

The device consists of a porous metal basket with a polyurethane filter, which is threaded past the blockage by way of a catheter. When the catheter is pulled back, the device opens like an umbrella, trapping debris but letting blood flow through. After angioplasty is completed, the AngioGuard is closed and removed. A team of German S. doctors reported in the journal *Circulation* that they’ve conducted angioplasty with AngioGuard in 25 patients. The team said the device collected emboli in all patients, indicating how dangerous it might have been if the debris had entered the blood stream. None of the patients suffered adverse effects during surgery. ■

RINGING BAD BEEF NO LIGHT BEFORE IT HITS SHELVES

LAST YEAR, MORE THAN 2.5 billion pounds of beef were recalled in the U.S. because of possible contamination by dangerous bacteria such as *E. coli*. To help squelch outbreaks of food-related illness, scientists at Iowa State University and the Agriculture Dept. have developed imaging technology able to scan beef carcasses and detect the most minute traces of fecal matter, which may harbor harmful pathogens. eMerge Interactive of Sebastian, Fla., has licensed the technology and built a prototype scanner called VerifEYE

for use by meatpackers. The system scans a slab of meat using light of varying wavelengths. An image of the beef is displayed on a monitor, with contaminated areas highlighted by a fluorescent glow. Meatpackers can then trim off those potentially harmful portions of beef. “This is a huge step in the right direction,” says James E. Kennedy Jr., director of research microbiology at ABC Research, a food-testing lab that participated in a trial of the system.

Image scanning can also provide liability protection for meatpackers when they are accused of passing along bad beef. Meat scans can be archived and later examined if a product batch is called



into question. VerifEYE is scheduled for commercial launch in late 2002. Researchers are working on similar technology for pork and poultry. *Darnell Little*

THE MICROSOFT CASE: TYING IT ALL TOGETHER

A critical deadline looms in the Microsoft Corp. antitrust case. On Dec. 7, the nine state attorneys general who are still suing the company plan to tell U.S. District Judge Colleen Kollar-Kotelly what restrictions they believe should be imposed on the software giant's conduct. Last month, Microsoft settled with the Justice Dept. and nine other states.

The key issue facing the dissenting states is whether they will target the company's most potent predatory tactic: bundling. That's the term used to describe Microsoft's practice of continually adding new features to Windows, the operating system installed on more than 90% of America's desktop computers. Because customers are essentially locked in to Windows, it's easy for the company to get them to use its other software—even if competitors make better products. That dampens competition, reduces choice, and could retard innovation.

Microsoft's rivals wanted Justice to restrict the company's right to bundle, but antitrust chief Charles A. James declined to do so. His position—and the company's—is that the D.C. Circuit Court of Appeals ruling in the case blocked a bundling remedy. But competitors and many antitrust experts disagree. Now they're trying to convince the states to try to restrict the company's bundling. If they succeed, it could have an enormous impact on the future of the entire software industry. Here is a close look at this confusing issue.

What did the D.C. Circuit Court of Appeals say about bundling?

The appeals court, in a decision that the U.S. Supreme Court has declined to review, held that the way Microsoft bundled its Internet Explorer into Windows violated Section 2 of the Sherman Antitrust Act. That's a law preventing companies from using predatory tactics to defend a monopoly. A wide variety of business practices can run afoul of Section 2, including everything from forcing business partners to sign exclusive contracts to predatory pricing. In this case,

seven appellate judges unanimously found that "the commingling of code... [had] an anticompetitive effect" because it deterred personal-computer makers from installing Netscape Communication Corp.'s (now a part of America Online) browser after it was introduced in 1994.

Three weeks after the ruling, on July 18, Microsoft petitioned the court to reconsider this part of its conclusions. The company acknowledged that the commingling finding "might be read to suggest that [computer makers] should be given the option of removing software code." It also asked the appeals court to bar trial judge Kollar-Kotelly from imposing any remedy that would force the company to unbundle some software from Win-

One of the most effective sources of Microsoft's power is bundling—its process of continuously adding features to its Windows operating system

dows. The D.C. Circuit responded with a curt "no." In another unanimous ruling, it rejected the petition and wrote:

"Nothing in the court's opinion is intended to preclude the lower [court]'s consideration of remedy issues."

So the bundling issue was a total loss for Microsoft, right?

Not entirely. Justice had also charged that the company's bundling violated Section 1 of the Sherman Act, which outlaws tying. That's the legal term used to describe the practice of exploiting a monopoly by forcing customers who need one of a company's products to buy a related product. It is the main weapon that is usually aimed at business practices such as bundling.

Former trial Judge Thomas Penfield Jackson ruled for the government, but the D.C. Circuit put aside his decision. It instructed the next judge to recon-

sider the facts in the light of a new legal standard. As a practical matter, a test would have involved balancing the convenience of a particular type of bundling against the potential loss of consumer choice and technological innovation. The court, in essence, put the ball back in Microsoft's court. So this part of the ruling was a standoff between the government and Microsoft—with the result to be determined sometime in the future.

This point has confused many people. That Microsoft's bundling was a violation of the law against monopolization, not the law against tying, seems illogical. But such rulings are common in the U.S. legal system. To make a rough analogy, imagine a crime in which a shooter kills Jim on a street corner. Prosecutors will charge Bob with at least two things: first-degree murder and reckless endangerment of all the bystanders who might also have been killed. Two different legal theories will be applied to the same underlying action. Say a jury convicts on both. If appellate judges instruct the lower court to reconsider the murder charge because some improper evidence

shown to the jury—Bob still might be convicted of reckless endangerment.

Did this ruling give the government enough ammunition to attack bundling?

That's the controversial question. Had Justice won an unambiguous victory on the tying, it clearly would have had the right to force Microsoft to stop bundling. But it didn't. And on Sept. 6, James decided to drop the tying claim altogether—depriving the judicial system of the best chance it may ever have to rule squarely on the legitimacy of Microsoft's bundling.

After Justice

ed the tying allegation, the gov-
nt still had its Section 2 monopo-
n victory. But there is a question
ow much punishment could be
ted by this ruling—just as there
be a question about how much
ne Bob would deserve for a reck-
idangerment conviction. Still, to
experts, the fact that Microsoft's
ng was deemed to be illegal under

Section 2 gave the government plenty
of ammunition to attack bundling, with
or without Section 1. "Monopoly mainte-
nance gives [James] the same legal fire-
power that the tying language would
have given him," says Brookings Insti-
tution antitrust expert Robert E. Litan.

What does James think?

The government's top trustbuster dis-
agrees. He says the only ruling that
could have supported unbundling was a
victory on tying. "Those who would like
to see this à la carte sales process are
not appropriately relating the legal theo-
ry that was left in the case to the" reme-
dy, he says. "That dis-integration reme-
dy was a remedy for the tying claim."

The Justice Dept. is taking a narrow
view of the scope of the government's
victory under Section 2. As Philip
Beck, the outside lawyer for Justice
hired to replace David Boies in the
case, argues: "The reason [the appeals
court] said commingling was bad was
because the effect of the specific commingling they were talking about was
to render it impossible [for computer
manufacturers] to use the add-and-

**If the remaining states want to restrict Microsoft's ability to bundle new soft-
ware into Windows, what remedies
might they seek?**

In a word, unbundling. That is to say,
forcing Microsoft to allow PC manufac-
turers to offer a version of Windows
without an Internet browser, media
player, or other types of software
thrown in. That would theoretically
give rivals a better chance to distribute
their products.

There are many different types of un-
bundling. Had the government won an
outright victory on tying, it potentially
could have stopped Microsoft from
putting any new features into Windows.
But the company's critics acknowledge
that a Section 2 monopolization ruling
supports only a narrower form of un-
bundling—specifically, a restriction on
the addition of so-called "middleware"
into Windows. The definition of middle-
ware is notoriously vague. But most peo-
ple consider it to be software that, like
Windows, supports a variety of indepen-
dent applications. If the company was
prohibited from bundling middleware, it
probably couldn't add a media player to

The Justice Dept. concluded it lacked legal authority to restrict the bundling. Many antitrust experts disagree—and want state attorneys general to take action

delete function,"
he explains. "What
the commingling
prevented was
the problem, not
the commingling
itself."

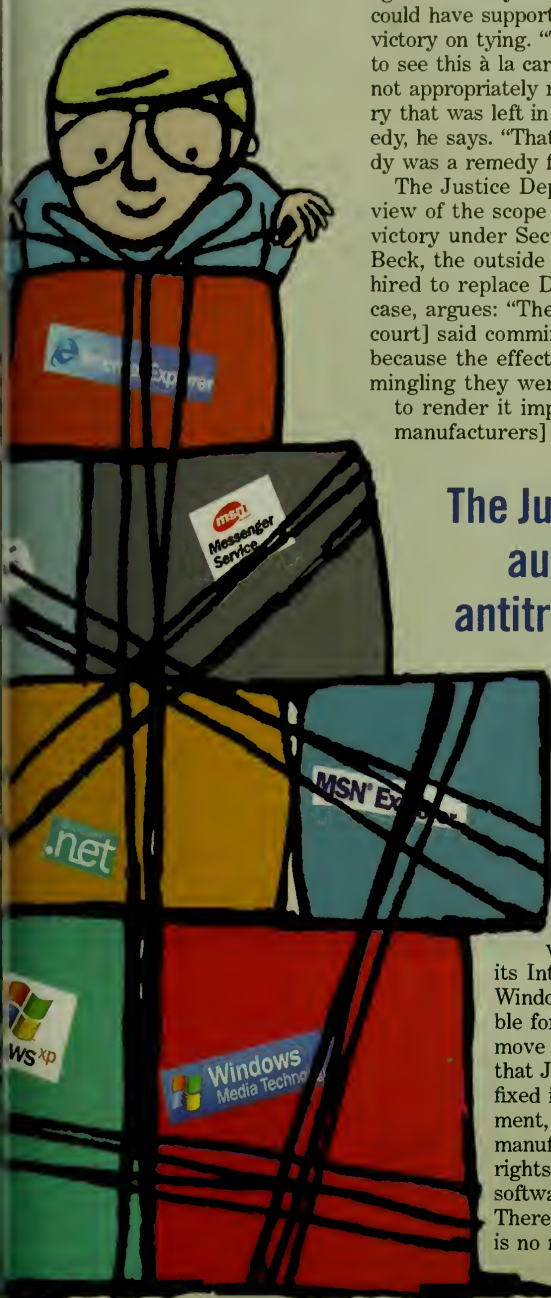
Translation: The
way Microsoft bundled
its Internet Explorer into
Windows made it impossi-
ble for PC makers to re-
move it. This is a problem
that Justice believes it has
fixed in the proposed settle-
ment, which gives computer
manufacturers broader
rights to pair non-Microsoft
software with Windows.
Therefore, Beck says, there
is no need for limiting
Microsoft's right
to bundling.

the operating system. In contrast, it
probably could continue to improve the
basic plumbing in Windows, say by
adding new file management or disk
compression software.

**What are the odds that the nine dissi-
dent attorneys general will attack
bundling?**

Hard to say. The attorneys general
are being lobbied by Microsoft's foes,
who say that no remedy will work un-
less it deals with bundling. But the
states are also apprehensive about im-
posing an unbundling remedy, which
would require them to define what be-
longs in the operating system and what
should be excluded—a thorny techno-
logical issue. That's why the betting is
that Microsoft will retain its right to
put whatever it wishes in Windows.

*By Dan Carney in Washington and
Mike France in New York*



SOFTWARE

GANGING UP TO COMPETE WITH MICROSOFT

Suddenly, there's a rush among rivals to form alliances

No sooner had Bill Gates arrived at the Las Vegas Convention Center for the Comdex trade show on Nov. 12, than he made a beeline for the Nokia booth. His quest: to examine the new 9290 Communicator, a combination cell phone and personal organizer. This was no friendly visit from a phone buyer, though. Microsoft Corp. has its eyes on the emerging cell-phone software market, putting mobile-phone leader Nokia Corp. increasingly in the Microsoft chairman's crosshairs.

That explains why Nokia helped launch a new mobile-phone consortium that day that could one day vex Microsoft. The consortium is trying to set technical standards for next-generation mobile phones and services that are independent of Microsoft's technology.

"A BIG THREAT." This group is just one of several alliances that have cropped up in recent weeks as companies have become increasingly worried about Microsoft's clout. They're banding together to prevent the software giant from dominating everything from mobile computing to a new generation of Web services. Their strategy: to push for industry standards on the Internet, not Microsoft's Windows. "We know that Microsoft is a big threat," says Sony President Kunitake Ando. "If everybody goes toward Windows and Microsoft technology, it's not so good."

Indeed, Microsoft is plowing into an

array of new markets. It competes with cell-phone makers Nokia and Motorola Inc. with its new technology for Web cell phones. It's taking on Sony and Nintendo Co. with its Xbox video game console. And its Passport



Web site authentication service, with 200 million accounts signed up, makes it a potential middleman between Web merchants and their consumers.

Microsoft's antitrust settlement with the Justice Dept. and nine states in November does little to restrain it from using its Windows monopoly to gain

ground in new markets. And on Nov. 20, Microsoft eliminated another potential constraint by settling consumer class actions, alleging it overcharged for Windows. The company agreed to spend \$1.1 billion to outfit poor schools with PCs.

With Microsoft unchained, the prospect of it becoming a powerful middleman on the Web helped spawn a new anti-Microsoft initiative, the Liberty Alliance. The 34-company group launched Sept. 26 with the promise of developing an alternative to Microsoft's Passport service. "It feels like they're creeping into a number of our businesses. We're suspicious," says one telecom exec. Other members include General Motors, United Air Lines, and Fidelity Investments.

Several of the companies that have joined the alliances are quick to point out that they're not on a mission against Microsoft. "The primary goal is to have Microsoft involved, as well as AOL and Yahoo! and every one else," says Liberty Alliance member Eric C. Dean, chief information officer of United Airlines Inc.

Microsoft says companies have nothing to fear. Although the company has its proprietary Windows operating system, it has increasingly embraced industry software standards for its Web products. "We have been talking about open standards longer than any one of these companies," says Steve Guggenheimer, Microsoft's senior director of business management. It

newest rivals feel they can't afford to wait and see if Microsoft is true to its word. So they're taking matters into their own hands. If history is any guide, those hands will be full.

By Jay Greene in Seattle, with Stephen Baker in Barcelona, and Pete Burrows in San Mateo

CLOSING RANKS

Companies want to protect their turf from Microsoft



INTERNET I.D.'S

ALLIANCE Project Liberty, a group of 34 companies

PROSPECTS Long-shot: Microsoft's Passport service has some 200 million accounts



CELL PHONE SOFTWARE

ALLIANCE The Open Mobile Architecture

initiative, a group including Nokia

PROSPECTS Strong: Microsoft's phone software is new and the alliance includes stalwarts



WEB DEVICES

ALLIANCE Sony teamed with AOL Time Warner

PROSPECTS Mixed: The two bring much to the table, but Microsoft has its own partners

STURDINESS MEETS HUSTLE



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With companies that supply electricity, broadband capacity and natural gas to one of the nation's highest population growth regions, we are able to maneuver wisely in any situation. For instance, when the energy market shifts, our diverse fuel mix enables us to respond by producing energy in the most cost-efficient manner. And our aggressive trading of energy on the open market gives us yet another way to enhance our bottom line. So, although we're structured for stability, when it comes to the future, we have no intention of standing still.



Progress Energy

BROADBAND

PLAYING CHICKEN ON THE INFORMATION HIGHWAY

Will bondholders pull the plug on Excite@Home's network?

It has been a dismal year for Excite@Home. The Redwood City (Calif.) provider of high-speed Internet access over cable television networks has seen its stock price fall from \$10 last November to 6¢ now. It has lost \$1.4 billion in the first nine months of the year. And on Sept. 28, the company filed for bankruptcy protection because of a severe cash crunch.

Now, things may get pretty rotten for

price. "If they're not willing to pay more, then they should be ready to see the service turned off," warns Don Morgan, a managing director at financial firm MacKay Shields, one of the largest bondholders.

Bondholders are playing a dangerous game of chicken because they feel they have little to lose. If the assets are sold for \$307 million, they figure they'll get almost nothing. AT&T's offer requires

band service is restored. A spokeswoman for Cox Communications Inc. acknowledges that "if they shut down the network on Nov. 30, our customer would lose their service."

The cable companies are vulnerable to an Excite@Home shutdown because of the design of its network. The cable players own the link from each broadband customer's house to the so-called head-end, a facility in each neighborhood that collects cable-TV programming and then zaps it to subscribers. From the head-end, their customers' Internet traffic is transferred onto the Excite@Home network, which carries it around the country.

ERODING VALUE. To bypass that network, cable players would have to install connections at every head-end where they have broadband customers. There are nearly 600 such locations around the country. The process could take

FIGHTING OVER THE SCRAPS

Excite@Home's bankruptcy has everyone scrambling to salvage something:

AT&T It's offering to buy Excite@Home's network for \$307 million. It wants to use the network to provide broadband Net access to its 1.4 million customers and, for a fee, those of the other cable companies.

BONDHOLDERS Now in control of the bankrupt company, they think \$307 million is too low. They say they'll shut the network down on Nov. 30 if AT&T doesn't increase its offer.

COX AND COMCAST They just want out of the mess. Both cable players are building their own Internet networks, which won't be ready if bondholders shut down Excite@Home on Nov. 30.



the 4.2 million customers who get broadband service over Excite@Home's network. Because of a fight in bankruptcy court over the company's assets, subscribers could see their service cut off in the next few weeks. "It'll be a customer-service nightmare," says analyst Jordan Rohan of Wit SoundView Corp.

LITTLE TO LOSE. At issue is Excite@Home's network, which almost every major cable company uses to transport the Net traffic of their customers. AT&T, the largest provider of cable TV and long-distance services in the country, has offered to buy the network for \$307 million so it can continue providing Net service to its 1.4 million customers and those of other cable players. But Excite@Home's bondholders, who control the company now that it's in bankruptcy, say they'll shut the company down before they sell the assets at such a low

price. "If they're not willing to pay more, then they should be ready to see the service turned off," warns Don Morgan, a managing director at financial firm MacKay Shields, one of the largest bondholders. Bondholders believe they would get less than \$50 million out of the \$307 million total.

The showdown comes on Nov. 30, when Judge Thomas E. Carlson hears both sides in U.S. Bankruptcy Court in San Francisco. To keep their customers from being stranded, the cable companies are scrambling to come up with alternatives for carrying their Internet traffic. AT&T and Comcast Communications say they're exploring their options, but decline to provide details. One analyst says AT&T is planning to offer free dial-up Net access until broad-

band service is restored. A spokeswoman for Cox Communications Inc. acknowledges that "if they shut down the network on Nov. 30, our customer would lose their service."

The standoff could be postponed. Judge Carlson could decide on Nov. 30 to force Excite@Home to continue providing service while he urges the two sides to come to an agreement. But bondholders argue that any postponement would hurt them. They contend that Excite@Home's assets are valuable now and will become less valuable as days pass—because AT&T and other cable companies will develop alternatives. "Waiting certainly gives the cable companies more alternative means to provide the service," says Andrew Watt, a debt analyst for Standard & Poor's.

If the bondholders and AT&T play this game of chicken to its ultimate conclusion, it will be Excite@Home's customers who suffer.

By Peter Elstrom in New York

E-GOVERNMENT

HONG KONG SAR
GOVERNMENT
TEAMS WITH COMPAQ
TO DELIVER ONLINE PUBLIC
SERVICES TO HONG KONG CITIZENS

How does the government deliver round-the-clock public services to 6.8 million citizens and save money at the same time?

This is the challenge the Hong Kong SAR Government is facing. Their goal is to broaden their reach to the citizens in a more effective and efficient way without sacrificing the quality of services they provide to the public.

New "instant access" approach
to government systems

The solution came in the form of developing the world's first bilingual public and commercial services portal for the community under a public-private sector partnership. ESDiff (www.esdiff.com) ESD Services Limited is a joint-venture entity in which Compaq is a technology provider. It is dedicated to implementing the core initiatives of the Hong Kong SAR Government's "Electronic Service Delivery Scheme."

The partnership won the Hong Kong SAR Government's contract in 1999 to implement the ESD system, because of the extensive experience of the joint venture companies in providing the technology, marketing and financial support required for such a challenging project.

In particular, Compaq is perceived as having the world-class solutions to support this mission-critical application, which requires high system availability, data protection. This includes secure infrastructure, proven data encryption, electronic authentication and payment systems.

Project will streamline
operations for
90,000 employees

more precise services, efficient and professional I.T. support is essential to our daily business. Compaq is a key partner in this effort.

Kenzie management—telecommunications and spend less time with someone else. They are a partner with the profes-

Since signing the agreement, Ericsson has been delighted by a decrease in response time and a corresponding increase in service quality. In outsourcing end-user support, Ericsson has achieved two seemingly incompatible goals: lowering costs and continued

ERICSSON
CALLS ON COMPAQ
Compag supports Ericsson in I.T. efficiency
efforts through selective outsourcing

By Daniel Klein

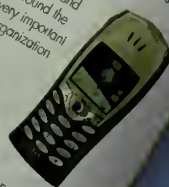
Ericsson, one of the world's leading telecommunications equipment companies, needs exceptional I.T. support in order to get the most from its 90,000 employees around the globe. Which left them with a challenge: how to provide them with the consistent and superior level of I.T. support they need.

Like many other industry leaders, Ericsson puts enormous effort into making their business processes as efficient as possible. One important ingredient in doing so is by ensuring that employees have access to the exact I.T. hardware and software they need, when they need it.

"At Ericsson, we are continuously looking for ways to improve our ability to respond to changing business demands. A standardized global I.T. platform that provides a consistent set of capabilities for all our people will give us the increased flexibility and cost-effectiveness we need. And because our global customers require faster and

sional capabilities to provide more efficient I.T. support, while allowing Ericsson's staff to focus on activities closer to Ericsson's core business.

The search started for partners who could match Ericsson's demanding requirements. Compaq was a preferred choice. Notes Ericsson, "We were already a big user of Compaq equipment, and their ability to supply and support us all around the world was very important for a global organization such as ours."



Compaq allowed Ericsson to coordinate the outsourcing of crucial I.T. services like a first-line help desk and on-site support, all on a single global platform. Measurement and control are assured by having a common model for reporting and tracking both cost and performance.

"Outsourcing today is about credibility. To be a successful global I.T. provider, hardware and professional services must be integrated, which is a clear Compaq strength in the eyes of our customers. We are pleased to provide Ericsson with a less expensive, more robust global infrastructure that ultimately impacts the bottom line," says Peter Blackmore, Executive Vice President, Compaq Sales and Services.

Since signing the agreement, Ericsson has been delighted by a decrease in response time and a corresponding increase in service quality. In outsourcing end-user support, Ericsson has achieved two seemingly incompatible goals: lowering costs and continued

COMPAQ

SHAKING UP THE COKE BOTTLE

Chairman Douglas Daft has been trying to energize the soda maker's bureaucratic culture—with mixed results

For a company as notoriously secretive as Coca-Cola, it was an extraordinary event: Last December, Chairman and CEO Douglas N. Daft invited some 50 Wall Street analysts and journalists to Atlanta for a rare peek behind the cola curtain. Having challenged Coke's chemists and marketers to think boldly, Daft flung open Coke's doors to display a dazzling array of prototype beverages and innovations—everything from energy drinks that let consumers control the amount of concentrate with a built-in pump to radio-controlled vending machines that let consumers buy drinks with a special key chain instead of coins.

Coming on the heels of a wrenching first year for Daft—which saw him ax 20% of Coke's 29,000 employees and reassign or sack 30 of his 32 top managers—the event seemed to be Daft's way of showing that the dirty work was done and the beleaguered soda giant was back. Known for both his charm and his temper, Daft compared Coca-Cola Co. to a prodigal son returning to its roots. "I cry a little bit," he said. "We're back to where we need to be."

But as he approaches his second anniversary at the helm, Daft is finding that turning around the beverage giant is harder than he might have expected.

Many of the cutting-edge drinks and oth-

er innovations Daft unveiled that day a year ago still sit in Coke's labs. And Daft's own attempts at being bold sometimes have backfired. Last November, Coke's board publicly vetoed his deal to acquire Quaker Oats Co. and its Gatorade drink; archrival PepsiCo Inc. bought it instead. And in September, Daft himself pulled the plug on a joint snack-and-juice venture he had initiated with Procter & Gamble Co. amid criticism that the terms favored P&G. Meanwhile, Coke's vaunted marketing team, which had been kept on a short leash during the reign of former CEO M. Douglas Ivester, has struggled to regain its voice. Coke's bottlers complain that the extra \$300 million Daft spent on marketing this year—a "one-time" shot to help reinvigorate its core brands—was wasted on ineffective ads. "To spend that amount of money and not have it work, that's absurd," grouses one bottler. "That was a big loss."

Even Daft has lowered his sights. After promising a skeptical Wall Street early last year that he could deliver the 15%-or-better gains in earnings per share that Coke achieved during the globalization boom of the 1980s, Daft lowered his goal for EPS growth last April to 11% to 12%—and may miss that target this year. J.P. Morgan Securities Inc. senior analyst John Faucher expects Coke's operating income this year to rise just 5%, to \$5.4 billion, on flat revenues of \$20.1 billion.

Part of the problem is that Coke's U.S. volume sales growth has slowed to an average of 3.9% a year since 1995, while PepsiCo has logged 4.5%-a-year growth because it has been more aggressive in moving into noncarbonated beverages—a faster-growing sector than



traditional soda. As a result, Coke stock, now at less than 50, is 25% below its level on the day in December, 1999, when the 58-year-old Australia native was named to succeed Ivester. PepsiCo, by contrast, has seen its stock rise 38% during the same period. Wall Street gives Daft high marks for undoing Ivester's mistakes, but not for finding a new formula for growth. "At the least Daft has stopped the bleeding," notes Faucher. "But are things moving ahead as fast as they should? No."

BRAND POWER. Coke executives maintain that they're making more progress than the numbers show. Chief Financial Officer Gary Fayard argues that if you take out the \$300 million spent on extra marketing, and adjust for currency swings, Coke would record a 12% rise in operating income this year. And the point to a bevy of initiatives that are starting to pay off. Thanks to strong gains by Coke's Dasani bottled water and its new Minute Maid Lemonade drink, the soda maker is finally making

AD BLITZ Says one bottler: "To spend that amount of money and not have it work, that's absurd"



DAFT'S SPOTTY REPORT CARD

In his first two years, Doug Daft has attempted sweeping changes at Coca-Cola. Here's how his initiatives have fared:

More Brands With the core cola market flat, Daft has pushed hard to diversify. Coke now has 1,500 different drinks, counting different sizes, around the world, vs. 1,000 a year ago. But Daft's bid for Quaker Oats was vetoed by his own board, and Daft himself backed out of a juice venture with Procter & Gamble. **Grade: C**

Cut The Fat Daft took an ax to Coke's bloated bureaucracy, ousting 20% of headquarters staff. Coke execs say decisions are now made faster, but critics say the cuts depleted a once-deep bench. **Grade: B**

Go Local In two years, Daft has failed to mount a coherent marketing campaign in the all-important U.S. market. And a move to tailor ads to local markets overseas has had mixed results. In Germany, Daft fired a top exec for ads that were too edgy. **Grade: D**

Mend Ties With Coke's bottlers in near-revolt, Daft has labored to mend relations—giving bottlers more leeway to market and invest as they see fit. But success may come at a cost: Coke may have to sacrifice some of its own profit to help nurse its bottlers back to health. **Grade: A**

Data: BusinessWeek

DAFT
WILL MISS
PROFIT
TARGETS
THIS YEAR

adway in the noncarbonated sector. And after a seven-year stretch in which Coke made few changes to its flagship Coke and Diet Coke brands, the company is rolling out several new spin-offs—including a lemon-flavored Diet Coke and eight-ounce Coke cans that neatly in a woman's purse. "We're gaining momentum and traction," says Daft. "The second-year execution of the strategy is exactly where we hoped it would be."

Despite vetoing the Quaker deal, Coke executives maintain that Daft has done a good job under the circumstances. "He's taken a difficult situation in what was a good company and done a very good job," says director Herbert A. Allen. And at least some investors are betting that Coke, given its brand power, will come back. "The moves he's making are the right direction," says Tim Drake, senior equity analyst for Banc One Investment Advisers, which owns 7.8 million Coke shares. "It hasn't shown up in earnings yet, but I think they're go-

ing to break out of where they've been."

In his former job as head of Coke's highly profitable Asian operations, Daft made his name building a lucrative coffee and tea business in Japan and for being quick to exploit new beverage trends. But so far, he hasn't been able to transfer that magic to the rest of Coke's sprawling empire. While Coke's Asian business remains robust, its Latin American operations are being hammered by the economic problems in countries such as Brazil and Mexico, as well as by the financial woes of its local bottlers. And, frustrated by the slow pace of change in Europe, Daft replaced his Europe chief, Charles S. Frenette, in July with Asia chief A.R.C. "Sandy" Allan. Back at home, some bottlers say the Coke mother ship is just as sluggish as ever: While they believe the new lemon-flavored Diet Coke will be a winner, they complain that the product was at least five months late—and missed the critical summer season. Coke's Americas chief, Jeffrey Dunn, says he delayed the launch to re-

jigger the taste, but is confident he made the right call. "The product we had in March would not have done as well as this product."

Retailers and rivals say they aren't yet impressed by Coke's innovations beyond its extensions of existing brands. Some retailers note that while Coke and Diet Coke continue to be mainstays, Coke still must develop breakthrough products for the all-important teen market to match PepsiCo's Mountain Dew and its SoBe line of nutrient-enhanced drinks. "Coke, Diet Coke, Sprite, that's all I need from them because that's the only value they bring," shrugs the buyer for one East Coast chain.

CHAIR MAN. Daft may be just as frustrated with the pace of change within the Coke bureaucracy as anyone else. Insiders say Daft was livid after his negotiators failed to complete a deal in October, 2000, to acquire new-age beverage maker South Beach Beverage Co. SoBe's owners became so upset by Coke's nickel-and-dime demands that they walked out and quickly cut a deal with Pepsi. (Daft counters that it was Coke that walked. "We didn't see the value," he says.) So the next month, when Daft discovered in a meeting with AOL Time Warner Inc. Chief Executive Gerald M. Levin that Coke was vying with Pepsi for marketing rights to Harry Potter films, Daft left nothing to chance: He didn't leave until Levin agreed to a three-year deal with Coke.

Daft couldn't be more different from his predecessor. While Ivester was a strictly by-the-numbers manager who showed little emotion, Daft can be both charming and volatile. While head of Asia, he once threw a chair across a meeting room. And insiders say his enthusiasm sometimes gets the better of him. They complain that he eagerly signs off on an initiative one day, then gives his blessing to a conflicting idea from a different manager the next. "Daft likes to make decisions," says one Coke manager. "The problem is, he likes to make them every five minutes."

He seems to understand the importance of advertising better than Ivester, who distrusted Madison Avenue, though Daft's efforts have yet to yield results. A series of ads a year ago featuring a wheelchair-bound grandmother and two feuding high school girls triggered a backlash among bottlers and consumers. And Daft says he axed a top exec at Coke's German operations for running TV spots aimed at the radical youth movement. Daft acknowledges that "no revolution is easy." Still, he'd better show some progress with this one—before investors run out of patience.

By Dean Foust in Atlanta, with Gerry Khermouch in New York

GIVING IT THE OLD ONLINE TRY

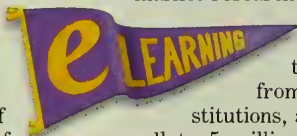
More people are clicking their way to degrees, creating huge opportunities for the education industry

The dot-com bubble may have burst in the world of commerce, but the promise of harnessing the Internet for paradigm-changing growth—and even profits—still thrives in the halls of academia. At the University of Maryland University College, enrollment in courses offered over the Net soared to 63,000 in the past academic year, up 50% from the year before. UMUC students can now earn some 70 degrees and certificates entirely online. The University of Phoenix Online, a subsidiary of the nation's largest for-profit university, saw revenues jump some 76% in the fiscal year ended Aug. 31, to \$181 million, while profits grew 82%, to \$32 million. The stellar results have driven up Phoenix Online shares by 80% since its parent, Apollo Group Inc., floated the unit as a tracking stock last year.

Since the U.S. Army began rolling out an e-learning program in January, 10,400 soldiers are taking courses and

earning degrees online from 24 participating colleges. Students at eArmyU, as it's known, receive a free laptop and printer and 100% of their tuition. No wonder the Army expects enrollment to hit 80,000 by 2005 as it takes the program Army-wide.

Nearly two years after the dot-com fizzle began, e-learning has emerged from the wreckage as one of the Internet's most useful applications. Nearly half of the 4,000 major colleges and universities in the U.S. now offer courses over the Internet or use the Web to enhance campus classes, according to market researcher International Data



Corp. About 2 million students take online courses from U.S. higher-ed institutions, and their ranks could swell to 5 million by 2006, estimates John G. Flores, head of the U.S. Distance Learning Assn., a nonprofit trade group outside Boston (charts, page 78). And it's not just a U.S. phenomenon: Students from developing countries are jumping online, too.

These courses are opening new horizons for the fastest-growing segment of higher education: working adults, who often find it difficult to juggle conventional classes with jobs and families.



Adults over 25 now represent nearly half of higher-ed students; most are employed and want more education to advance their careers.

E-learning is an influence in the traditional college class as well. Online classes won't replace the college experience for most 18-to-24-year-olds. But from the Massachusetts Institute of Technology to Wake Forest University in North Carolina, colleges are using t

ONLINE U *As e-learning has exploded, hundreds of universities and for-profit start*

UNIVERSITY OF MARYLAND UNIVERSITY COLLEGE

(www.umuc.edu) The largest state university to offer online courses allows its 63,000 students to earn some 70 different degrees and certificates online.

PRICE \$197-\$500 per semester hour, same as UMUC extension courses.

FINANCES UMUC had offered extension courses since the 1940s before moving to e-learning. Online revenues up 70% this year, to \$36 million.

UNIVERSITY OF PHOENIX ONLINE

(<http://online.uophx.edu>) The largest for-profit virtual university offers the same mix of education and technical courses as the University of Phoenix.

PRICE \$400 to \$500 per credit; an MBA costs about \$23,000.

FINANCE Publicly traded with a market value of about \$2 billion. Net income rose 82%, to \$32 million, in the fiscal year ending Aug. 31, as revenues grew 76%, to \$181 million.

eARMYU (ARMY'S VIRTUAL UNIVERSITY)

(www.eArmyu.com) Enlisted soldiers take courses from 24 institutions; so far, 10,400 soldiers have signed on the three bases where it's offered.

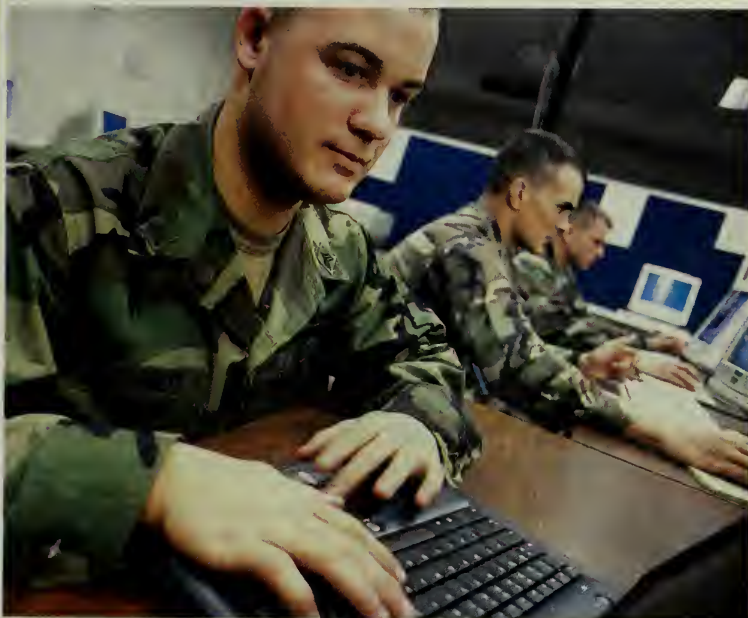
PRICE Free to soldiers, who also receive a laptop, printer, Internet connection, and 100% of tuition for college they enroll in.

FINANCES Last year, the Army awarded PWC Consulting a \$453 million contract to develop eArmyU.



Working adults, the fastest-growing segment of higher education, are logging on big-time. Is the developing world next?

ROWE (LEFT) GRADUATED LAST YEAR; DELLINGER (BELOW) IN CLASS



eb in on-campus classes to augment textbooks and boost communication.

There are still plenty of hurdles to clear before the e-learning world can take off. For one thing, most of the success is with established universities, like UNC, which can leverage their brand names to reach out to working adults. For-profit startups, by contrast, have struggled with accreditation and poor name recognition. Many have fallen by

the wayside, including BigWords.com, an Amazon-like purveyor of textbooks, while only a handful make money, like Phoenix Online.

MASS MARKET? Quality is a problem, too, which is a key reason why many online students drop out. That will force a further shakeout, eliminating mediocre players. Many colleges also are still grappling with such issues as how much time their faculty should devote to e-

teaching. And long-established rules make it difficult for online students to get financial aid. Even as these problems are resolved, "online learning will never be as good as face-to-face instruction," argues Andy DiPaolo, director of the Stanford Center for Professional Development, which offers online graduate courses to engineers.

Still, spending on higher-ed e-learning technology will more than double by

Offering courses over the Web. Here's a sample:

WESTERN GOVERNORS UNIVERSITY

(www.wgu.edu) Virtual university founded by a coalition of 19 Western states in 1997.

About \$4,500 for a two-year degree. Students also pay for courses, which are offered by some 40 different institutions.

FINANCE Backed by \$20 million in grants from federal government and private corporate sponsors, including Microsoft, and IBM.

CONCORD LAW SCHOOL

(www.concordlawschool.com) Nation's largest online law school, with 800 students. Graduates can take the California bar exam, but Concord isn't accredited by American Bar Assn.

PRICE \$6,000 a year, or \$24,000 for a four-year law degree.

FINANCES Founded by college test-prep king Kaplan Inc., a unit of *The Washington Post*. Kaplan says Concord will be profitable this year.

DUKE'S FUQUA SCHOOL OF BUSINESS

(www.fuqua.duke.edu) "Blended" MBA programs for working executives, in which 65% of the work is done over the Net and 35% in classes that meet for 9 or 11 weeks during two-year programs.

PRICE Up to \$90,000, versus \$60,000 for normal daytime MBA.

FINANCE Revenues from these popular programs are allowing Fuqua to double its faculty.



It's a bumpy road: Course quality varies, and getting accreditation takes years

2005, says Eduventures.com, a Boston-based education market researcher. The current economic slump could even spur enrollments, economists say, since many workers look to retool during downturns. Within four or five years, online universities could be among the largest higher-ed providers, says Andrew Rosen, chief operating officer of test-prep king Kaplan Inc., which has several online colleges, including Concord Law School, the largest virtual law program, with 800 students.

Ultimately, the greatest e-learning market may lie in the developing world, where the population of college-age students will explode in coming years. Just as cell phones leapfrogged land-based telephones in many developing countries, so may e-learning help to educate the masses in countries that lack the colleges to meet demand—and can't afford to build them.

ROAD WORK. Looking way out, as far as midcentury, e-learning could “become the environment in which the majority of human beings are educated beyond the secondary level,” asserts University of Melbourne President Alan Gilbert. His school, along with Canada's McGill University and more than a dozen other universities, is part of U21 Global, a virtual university being created through a joint venture with textbook giant Thomson Learning. It aims to enroll 100,000 students by the decade's end, mostly in Asia.



WHY COMMUTE? Dentist Kaner is picking up a law degree online

Meanwhile, e-learning demand in the U.S. is rising, driven by higher education's changing demographics. Take Dr. Michael Kaner, a 43-year-old dentist in suburban Philadelphia who's halfway through adding a law degree to his credentials. Attending a night program at an area law school wasn't practical, he says, since it would have required 12 hours of commuting a week. So in 1999, Kaner signed up for Kaplan's Concord law program. Although the courses require 25 to 30 hours a week, there's no commute and he studies when it suits him. “This is the only way I could pursue a law degree,” says Kaner, who hopes to build a part-time legal practice specializing in dental issues.

Similarly, Judy Rowe, who dropped out of college in the 1960s after run-

ning out of money, was able to earn a bachelor's degree in psychology from UMUC last year while working as a flight attendant for American Airlines Inc. “I took my laptop with me and did my assignments on the road,” says Rowe, who's now thinking about a second career in psychology.

COST-EFFECTIVE. E-learning is also a good fit with the military, where frequent transfers make it hard to pursue a degree. Last year, the Army awarded PWC Consulting a \$453 million, five-year contract to create an electronic university that allows soldiers to be anywhere and study at

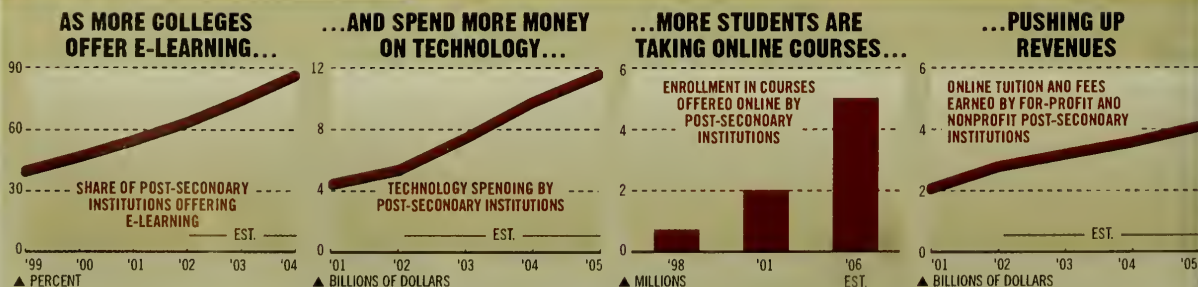
Kansas State University or any of the 24 colleges involved in the program.

eArmyU already has changed the perspective of soldiers like Sergeant Jeremy Dellinger, 22, who had been planning to leave the Army to go back to school when his basic enlistment ended. Then he enrolled in eArmyU to earn his bachelor's degree from Troy State University in Alabama. “Now I can get my degree and still do the work I love as a supply sergeant,” says the Fort Benning (Ga.)-based soldier. Like Dellinger, about 15% of those who have signed up so far have reenlisted or extended their tours. By cutting turnover, “eArmyU could almost pay for itself,” says program director Lee Harvey, since it cost nearly \$70,000 to train green recruits.

Corporations, too, see e-learning as

THE E-LEARNING EXPLOSION

As colleges push into cyberspace, students sign up





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So far, traditional universities, rather than e-learning companies, are the big winners

a cost-effective way to get better-educated employees. Indeed, corporate spending on e-learning is expected to more than quadruple by 2005, to \$18 billion, estimates IDC. At IBM, some 200,000 employees received education or training online last year, and 75% of the company's Basic Blue course for new managers is online. The move cut IBM's training bill by \$350 million last year, because online courses don't require travel.

Even as online higher ed catches on, however, few private-sector providers are turning a profit. During the boom years, venture capitalists pumped some \$5 billion into e-learning companies, says Adam Newman, a senior analyst at Eduventures.com. Roughly \$1 billion went to companies that have already flamed out, he says. Beyond Phoenix, probably only half a dozen companies are making money now. Lack of name recognition is the biggest problem for companies like Capella, Jones International, and Cardean, UNext's virtual campus. And winning accreditation—crucial for attracting students—is tough going, too. It took Capella five years to make the grade; Jones waited four years. Concord's grads can sit for the California Bar Exam, but the American Bar Assn. still hasn't granted it accreditation.

CAUTIOUS ELITES. Even Phoenix Online, which has piggybacked on the fame of the bricks-and-mortar University of Phoenix, lost millions in its first six years, says Todd S. Nelson, CEO of parent Apollo Group. To hold students, Phoenix Online keeps classes small and insists on student involvement. "I had to sign on five of every seven nights," says Martin J. Boyle, the owner of a New Jersey-based security company who earned a Phoenix Online MBA last year.

Phoenix Online aside, the big e-learning winners so far are the traditional nonprofit universities. They have captured nearly 95% of online enrollments, figures A. Frank Mayadas, head of e-learning grants at the Alfred P. Sloan Foundation. Most active are state and



LAPTOP LECTURE: Wake Forest's Brown leads a freshman seminar

community colleges that started with strong brand names, a faculty, and accreditation, says Mayadas, as well as a tradition of extension programs.

By contrast, many elite universities have been far more cautious about diluting the value of their name. Harvard Business School believes it would be impossible to replicate its classroom education online. "We will never offer a Harvard MBA online," vows professor W. Earl Sasser, chairman of HBS Interactive, which instead develops e-learning programs for companies. Similarly, last year the MIT faculty nixed teaching classes online, fearing "it would detract from the residential experience," says former faculty chair Steven Lerman.

That didn't stop MIT from embracing the Internet in a different way. Over the next five years, MIT plans to post lecture notes and reading assignments for most of its 2,000 courses on the Web for free, calling the effort "OpenCourseWare." Lerman says "it's a service to the world," but he says it's no substitute for actual teaching, so faculty aren't worried about a threat to classroom learning.

A few other top schools see profit-making opportunities. Since 1996, Duke University's Fuqua School

of Business has been offering MBAs for working executives. In these blended programs, some 65% of the work is done online and just 35% in classes held during required residencies that consume 9 to 11 weeks over two years. Duke charges up to \$90,000 for these programs—versus \$60,000 for its traditional residential MBA. Yet they have been so popular that by next year, "we'll have more students in nontraditional programs than the daytime program," says Fuqua Dean Douglas T. Breeden. The extra revenues are helping Fu

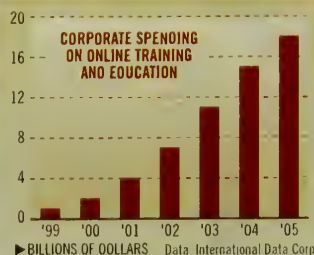
qua to double its faculty.

"MORE ENGAGED." Even colleges not pursuing online courses are integrating the Internet into everyday campus life. Professors are using everything from digital reference works to Web-based tutors to augment textbooks. Colleges are rethinking classroom instruction, too. MIT has redesigned a semester of its mandatory undergrad physics course, replacing an impersonal lecture to more than 100 with lively sessions in which groups of three students with laptop solve problems posed by the professor. At Wake Forest, where all students receive laptops, Vice-President David C. Brown asks students in his freshman seminar to e-mail drafts of their papers to two fellow students, plus one of six alumni Brown has recruited to provide comments. Brown then e-mails papers, with his comments, to all students. "Students are more engaged," says Brown.

Change comes slowly to higher education, but e-learning has revved up the pace. Even if it takes years to fully take hold, it has already achieved one oft-cited goal of the knowledge economy: getting more adults studying throughout the working lives.

By William J. Symonds in Boston

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THE ADMINISTRATION

THE PRESIDENT'S STEALTH MISSILE

Josh Bolten is the most important Bushie you never heard of



In the popular TV show *The West Wing*, the President's deputy chief of staff is also a brainy charmer named Josh Lyman. In the real West Wing, the President's deputy chief of staff is also a brainy charmer named Josh, but that's about where life imitating art—or at least TV—ends.

Unlike the sometimes testy, often-distracted, high-profile Josh Lyman, Joshua Bolten is quiet and self-effacing, a trim man with a prep-school education, a Princeton diploma, and a Goldman Sachs pedigree. In fact, Bolten, 47, is so low-profile that almost a year into the Bush Administration, he is virtually unknown to the public.

That's why it's so easy to underestimate the power Bolten wields. Among his responsibilities, Bolten coordinates all Administration policy initiatives, closes deals on Capitol Hill, and since September 11, chairs a new, high-level com-

mittee. He has played a pivotal role in issues ranging from anti-terrorism legislation to health-care policy. "He's not a showboater, but he gets results," says Margaret La Montagne Spellings, Bush's chief domestic policy adviser.

TOUGH NEGOTIATOR. Bolten operates with two guiding principles: absolute loyalty to the boss and absolutely no attention to himself. Indeed, his penchant for secrecy befits the son of a career CIA officer. One White House colleague notes that Bolten for months had a sign on his desk declaring: "Who else needs to know?" Bolten has not granted an on-the-record interview since Bush's inauguration, and he turned down numerous *BusinessWeek* requests for comment.

White House Press Secretary Ari Fleischer says Bolten "doesn't want to" talk to reporters and "doesn't view it as [part of] his position." A rare native Washingtonian in a White House top-heavy with Texans, Bolten "believes his role is to develop the best policy positions but

BUSH AND "YOSH"

Bolten's command of complex issues rapidly won the confidence of the President's inner circle

not be a player in his own right," says Representative Rob Portman (R-Ohio), a former colleague from the first Bush White House.

That doesn't mean Bolten is a pushover: He is a tough negotiator who honed his "closer" skills at Goldman Sachs in London. When Bush faced imminent defeat in the battle over a patients' bill of rights this summer, Bolten turned up the heat on Charlie Norwood (R-Ga.), the House's point man on the issue. After Norwood finally agreed to a deal acceptable to Bush, Bolten marched him into the White House briefing room to announce the compromise—before Norwood's erstwhile allies could try to talk him out of it. One senior Republican aide says Bolten's "extremely tough" tactics could cost Bush over time. "Bolten sacrificed an ally to make sure the President didn't have a [political] loss," the staffer says.

In many ways, the man dubbed "Yosh" by the President is a study in contradictions. He went to the same tony Washington prep school as former Vice-President Al Gore but drives to the White House in an old pickup. He has an Ivy League look yet played lead guitar in a high school rock band. And he's the soft-spoken single guy who turned heads in Bushland by hanging out with Bo Derek at the Republican National Convention.

An outsider in the close circle of Presidential confidants, Bolten had never even met Bush before he was hired as the top policy staffer for the 200

JOSHUA BOLTEN

AGE 47

JOB TITLE Assistant to the President and Deputy Chief of Staff for Policy

HOMETOWN Washington

EDUCATION St. Alban's, Princeton (AB, 1976), Stanford Law School (JD, 1980)

MARITAL STATUS Single

PREVIOUS GOVERNMENT EXPERIENCE International Trade Counsel, Senate Finance Committee (1985-89); General Counsel, U.S. Trade Representative



umpaign. He gave up his Goldman Sachs job and in short order won the confidence of the Texas "Iron Triad"—strategist Karl Rove, communications guru Karen Hughes, and campaign manager Joe Allbaugh—with his command of complex questions.

No wonder Bush keeps increasing the size of Bolten's portfolio. His most recent acquisition: chairman of the Domestic Consequences Principals Committee, whose mission in the aftermath of September 11 is to move quickly with policy responses to terrorist attacks. Among the issues the group has addressed: counterterrorism legislation, an aid package for laid-off workers, and airline- and insurance-industry bailouts. **CE GUY, TOO.** On Capitol Hill, he plays a policy role usually reserved for the chief of Staff. Working with White House legislative lobbyist Nick Calio—his former boss in Bush I—Bolten sets strategy and cuts deals while Calio sells the Administration's agenda on the Hill. And he decides when and how to present policy options to the President. "His job is to keep the horses pulling in the same direction," says one friend. Although he isn't as forceful, Bolten is considered one of the few genuine "nice guys" in Washington. "He's hugely talented and enormously easy to get along with," says former U.S. Trade Representative Carla Hills, whom Bolten served as general counsel in the first Bush Administration. With many of his colleagues preoccupied by the war on terrorism, the setative Bolten is more valuable than ever as he works to keep the rest of the Bush agenda moving. But he'd rather let the outside world not know. As one of his friends notes: "He's happiest when he's out of the limelight." Sorry, Josh.

By Richard S. Dunham

(1992); Deputy Assistant to the President for Legislative Affairs (1993)

EMIC EXPERIENCE Taught international trade at Yale Law School (1990)

ITICAL EXPERIENCE Policy director, Bush-Cheney 2000

ITE SECTOR EXPERIENCE Partner, O'Melveny & Myers; Executive Director, Legal & Government Affairs, Goldman Sachs International (1999)

IES Motorcycles, listening to heavy music

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SECURITY

TAKING PRECAUTIONS —OR HARASSING WORKERS?

Arab Americans say employers are violating their rights

Last month, security officials at FedEx Corp.'s sorting center at Newark Airport became alarmed when they heard the eerie details of a rumor making its way through the plant: A contract mechanic named Osama Sweilan had been periodically disappearing into the company's flight-simulator room. The security men quickly set up an interrogation at an off-site warehouse, where the Egyptian-born 35-year-old says he nervously explained how he sometimes slipped into the room to make sure a pipe he'd fixed wasn't leaking. He also made a few quick calls to his wife. Occasionally, he told them, he even prayed. They pressed him further, he claims, asking about his beliefs regarding politics and Osama bin Laden. Afterward, they confiscated his ID and told his outsourcing firm that he was no longer wanted in his 16-month-old job.

NAME GAME? Even staunch civil libertarians concede they can see why FedEx, which says it can't comment on the situation, was initially concerned. What they have a problem with is the alleged discrimination and subsequent dismissal that Sweilan says was the result of profiling a Muslim who happens to have the same first name as the most wanted man in the world.

Sweilan is one of a growing number of Arab Americans who allege they are victims of a new, post-September 11 wave of workplace discrimination, one they claim is legitimizing privacy violations and unfair firings under the rubric of corporate security. Some say they have lost their jobs after being questioned—and cleared—by the FBI, while others complain of being turned away by recruiters or informed that they can no longer count on their



companies' support in getting H1B visas.

This heightened wariness of anyone who is or appears to be from the Arab world is yet another new feature of the post-attack workplace. Arab American advocacy groups report as many as 1,000 complaints of September 11-related discrimination and harassment, with the most recent batch of which originated on the job. "We have people being targeted at work who have lived in this country for 25 years with no

record of any violation," says Imad Hamad, the Detroit-based regional director of the American-Arab Anti-Discrimination Committee. The Equal Employment Opportunity Commission is investigating 100 such cases and has created a special category for the claim and a new task force. "We're beginning to see a backlash," says EEOC chair Carl M. Dominguez.

Many of the charges come from workers in the security and airline industries, such as aircraft mechanic Mamdouh Bayoumy, who alleges that Boeing Co. renegotiated a job offer in San Antonio. Bayoumy, an Egyptian, says the company claimed it could not "secure his background" despite his 10-year track record of work in the U.S. and good references. Boeing declined comment.

The claims highlight the tightrope Corporate America walks as it balances its role as a kind of secondary special-operation force for homeland security with upholding the rights of employees. Targeted workers and their attorneys say so.

FIRED AT FEDEX: Osama Sweilan says he did no wrong

businesses—in rifling through employees' possessions, asking intrusive questions, or forcing some to take leaves—have gone too far. Company lawyers counter that their corporate clients have an increased responsibility to know who is working for them. Still, "if a client tells me they are concerned about a foreign worker on their payroll, my first question is, 'Were you concerned before September 11?' If not, we have to be very careful," says Jo Anne C. Adleson, a partner at labor law firm Proskauer Rose.

Many in the Arab American community worry that companies are being too careful—and not hiring them. Sweilan says he has faxed over 14 résumés but has yet to receive a single reply. Some could chalk it up to the weak economy, but Sweilan doesn't. "I hope my son never has to go through this," he says. "His name's Muhammad." It will be a long time, many lament, before a nation like that loses the stigma of September 11.

By Michelle Conlin
in New York

A NEW BIAS?

A growing number of Muslim and Arab American employees are filing discrimination charges. Some complaints:

- ▶ Getting fired after they've been questioned—but cleared—by the FBI
- ▶ Not being accommodated for daily prayer and foot-washing rituals
- ▶ Bans on turbans and head scarves
- ▶ Employers disregarding religious and racial slurs at work

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THE LITTLE GUYS GET SOME RESPECT

Smaller research firms are enhancing their cachet as the giants slash their payrolls

When Henry Blodget, the controversial Internet analyst, resigned from Merrill Lynch on Nov. 15, he made the headlines. But he was just one of the latest and more high-profile victims of Wall Street's latest round of bloodletting. As big brokerage houses and investment banks rush to prune costs, they are finding analysts, and the research they produce, prime candidates for cutting.

Hundreds of analysts and support staff are among the 18,500 who lost their jobs at securities companies in the seven months preceding September 11. And there has been no letup since. In mid-November, Goldman, Sachs & Co. dropped 50 people from its research shop. Citigroup's investment banking subsidiary, Salomon Smith Barney, let 300 people go on Nov. 8, including a dozen from its equity staff. Morgan Stanley Dean Witter & Co. dropped four analysts at about the same time. This on top of a wave of consolidation among investment banks that has left whole research teams jobless. "We've seen a significant culling of research capacity" on Wall Street, says Sean Ryan, head of equity research at small broker Fulcrum Global Partners.

DECIMATION. The decimation in the big houses is playing into the hands of smaller shops such as Fulcrum, which has doubled the number of analysts it employs to 14 since May. Independent research firms—which sell reports or earn commissions from clients' trades—are attracting new clients among big institutions such as pension funds. One

appeal: Most of the small fry don't do investment banking business with companies, so they have less reason to placate company management with positive recommendations. Off Wall Street, a decade-old Massachusetts boutique that only issues sell recommendations—a traditional no-no among most big banks—has added two analysts this year, bringing the number to eight, as demand for its research increases. There's some evidence that smaller shops are better stock pickers. "They consistently rank in the top 5 or 6" by performance, says Kei Kianpoor, CEO of Investars.com, a Web site that ranks analyst picks. "They're a lot better than a many of the investment banks."

Certainly there's little denying that Wall Street's research effort, which has faced widespread criticism for its large compo-

ment of hype, is getting skimpier by the day. The big houses are suddenly dropping coverage of whole sectors. For instance, many no longer cover motor vehicles, or competitive local telephone exchanges, that were highfliers until last year. Morgan Stanley recently reduced coverage of the machinery and Canadian telecom industries. Goldman Sachs stopped following five real estate companies in June, because it has fewer analysts on the sector.

Meanwhile, spending by big banks on support staff and travel to visit companies is going out the window. Indeed, budgets at one top-tier firm have gotten so tight that a senior analyst there pays the monthly bills for his staff's Black-

ON THE STREET
Blodget, Merrill's star Net analyst, took a buyout

FROM BAD TO WORSE?

Research at big Wall Street is flagging as:

LOWER BUDGETS cut into salaries, jobs, and expenses

ANALYSTS DEPART for small firms that are flush with cash

COVERAGE of industries and companies is reduced or dropped

DISILLUSIONED INVESTORS search for new ideas from independent research shops

Data: BusinessWeek



rrys—a portable e-mail device—out of
own pocket. “I just said fine, send
the invoice, I’ll pay for it,” he says.
need my staff 7 by 24.”

Outside forces are at work, too. Big
nks’ research shops have lost much of
eir cachet because of Regulation Fair
closure. This Securities & Exchange
mission rule, put in place last year,
quires public companies to share any
ce-sensitive information they want to
ulge simultaneously with private in-
stors, boutique shops, and investment
nks alike. Previously, earnings calls
ld be limited to a handful of firms,
d company executives would routine-
give information first to the analysts
ey liked the best. Inevitably analysts
big banks won out. “Now I listen to a
cent amount of conference calls my-
f,” says Andy Rich, portfolio manager
Treehouse Capital. For investment
as, Rich relies increasingly on small
utiques. “They are just a better
orce of ideas,” he says.

RBING PAYCHECKS. Cost-cutting on
Street is helping the 70 to 100 small
ops to attract talent they couldn’t
ve hoped for two years ago. That’s
cause paychecks for analysts em-
oyed by the big investment banks
ve been cut way back this year.
alysts make from \$100,000 to
0,000 in base salary—but another
% to 1,000% in bonuses related to the
vestment banking business they help
ng in. Now that deals have dried up,
auses have too, and there’s little dif-
ference in compensation between big
d small firms.

Still, longtime industry watchers
ve seen it all before. “There has been
cyclical pattern to this,” says Chuck
ll, director of research at Thomson
nancial/First Call. “Brokers cut back
d boutiques hire some of them.”
en, when times are good on Wall
reet, analysts return to the big
npanies.

But, with access to financial informa-
on and analysis easier than ever,
hanks to the Internet and Reg FD,
that pattern may change. If the in-
dependents really are better stock-
pickers than the giants, they
could have a bright future.

*By Heather Timmons
in New York*

‘WE’RE BULLISH, WITH A LOWER-CASE B’

There’s no shortage of grim news
in the markets: escalating layoffs,
profit shortfalls, and shrinking
capital spending. The economy
shrank in the third quarter, too, and
is forecast to contract further. To top
it off, investors are more than ever
sour: The Securities Industry
Assn. says that 22% of investors, the
most in seven years, think that next
year will be “bad” or “very bad” for
owning equities.

But all that may
really be good. Wall
Street pros, thinking
that wholesale nega-
tivity is a contrarian
indicator, couldn’t be
giddier. “Now, just a
hint that things are
getting better and
there’s confetti in
the streets,” says
Timothy J. Leach, a
chief investment offi-
cer at Wells Fargo
& Co. Crossing the
technical threshold
for a bull market,
the Dow Jones in-
dustrial average
gained 20% through
Nov. 20 from a Sept.
21 low. The Stan-
dard & Poor’s 500-
stock index rose by

18%; while better-than-expected
earnings from tech bellwethers, such
as Hewlett-Packard Co., boosted the
Nasdaq composite index by 32%.

CAUSE FOR OPTIMISM? Wall Street
bulls say the trend is for real. Small
company stocks, which often lead re-
coveries, have outdone the S&P since
September. Since March, growth
stocks have risen faster than value
stocks. A market rising despite bad
news “is the classical early stage of a
new bull market cycle,” says CIBC
World Markets strategist Subodh
Kumar. He credits the Federal Re-
serve’s 10th interest-rate cut on Nov.
6, bringing the federal funds rate to
2%—the lowest since 1961—for sus-
taining the turnaround. He also fore-
casts better earnings growth over
the next 12 months and renewed
tech spending. What’s more, there’s a

record \$2.23 trillion in money-market
assets just waiting to pounce.

True, some of the most active
trading has been in thrashed tech
stocks—Global Crossing, Lucent
Technologies, EMC, and Northern
Telecom—which could get taken
back down. “But even though you
are going to get corrections, the big-
ger picture is that you are not going
back to new lows,” says Hersh Co-

hen, a fund manager
overseeing \$8 billion
at Smith Barney As-
set Management.
Even amidst the
panic after Septem-
ber 11, “the market
went only 10% be-
low its spring lows,”
says Cohen. “If the
bear market was go-
ing to continue, it
would have kept go-
ing lower.”

A few bold bulls
are calling a bottom.
Birinyi Associates
Inc., a research firm,
says institutional in-
vestors are making
bigger bets, herald-
ing a market turn.
“We’re bullish, with
a lower-case b,” says
Jeffrey Y. Rubin, re-

search director. He cautions against
relying on conventional indicators of
a market bottom: Gauging how many
stocks go up against those falling—
advance/decline ratios—failed to call
bottoms in 1970, 1982, and 1990.
Waiting for a massive sell-off may
not indicate a trough either, or even
be in the cards.

The linchpin in the markets’ re-
covery is still earnings. And while
they’re nothing to write home about
yet, S&P corporate profits were high-
er in the third quarter than in the
second, and they beat consensus es-
timates, too. If the trend sticks, the
rise in stock prices will get funda-
mental support. And investors will
have every reason to feel good
again.

*By Mara Der Hovanesian
in New York*

A REAL RALLY?

*Although Main Street is skeptical,
Wall Street thinks the bull is back*



PENSION PLANS

\$40 BILLION SHORT?

Yes—unless Congress acts fast to change pension law

With their earnings withering in a weak economy and their banks getting stingier with loans, America's companies have been fighting for months to conserve cash. Next year, whatever they have scraped together could fly out the window. Unless they can prod Congress to act quickly, businesses may have to pour as much as \$40 billion of cash into needless contributions to top off their defined-benefit pension plans, according to pension consultants Watson Wyatt & Co.

The problem is that the yields, or effective interest rates, on 30-year U.S. Treasury bonds play a crucial role in federal pension law. The Internal Revenue Service forces companies to use a four-year average of the long bond yields to figure out if their pension plans are adequately funded—even if their investments are earning higher returns. The lower the yields, the more the plans have to pump up to meet potential future payouts. Lately the yields have been pushed down as bond prices were

bid up. This is because long bonds have been in short supply for months. The last straw came on Oct. 31 when the Treasury announced that it will no longer issue 30-year bonds.

NO CHOICE. The bottom line is that long-bond yields are a full percentage point too low compared with similar corporate bonds, according to the American Academy of Actuaries, whose members do many of the calculations for defined-benefit plans. Under current law, though, companies can't use a more realistic substitute, such as top-quality corporate issues. The rules have no bearing on 401(k)

A COSTLY FAREWELL TO THE 30-YEAR TREASURY

The sharp fall in yields on the government long bond—the benchmark for deciding whether company pension funds are properly funded—could cost companies plenty by:

- Forcing big cash payments into plans that become technically underfunded
- Increasing the size of lump-sum payments to employees leaving the plans
- Raising insurance premiums due to the Pension Benefit Guaranty Corp.
- Triggering extensive corporate disclosure, including advance notice of mergers

Data: American Academy of Actuaries, Milliman USA



defined-contribution retirement plans.

For the average pension scheme, the one-percentage-point error exaggerates the current value of its future obligations by 12% to 15%, says Ron Gebhardt, senior pension fellow at the academy. Companies are leery of discussing their own situations, but actuaries describe a manufacturer that

will have to cough up \$40 million, a food-service company that will owe \$60 million, and a consumer-goods company facing an \$85 million tab. In one extreme case, an employer will have to contribute \$10,000 for each worker. "Unless the funding requirements are adjusted, industry could find itself laying off more people at the same time it is forced to overfund pension plans," warns William R. Timken Jr., chairman and chief executive of the Timken Co., a Canton (Ohio) bearings maker.

Other types of organizations, such as charities, will be hit, too. The United Jewish Appeal-Federation of

Jewish Philanthropies New York is facing a \$7 million increase in its contribution next year over and above the \$7 million actuaries believe is needed to cover its obligations. That's more than \$1,400 for each of the 7,000 employees covered.

Unnecessary make-good payments are just the start. Some companies will be socked for high insurance premiums from the Pension Benefit Guaranty Corp. (PBGC) charged by the government with making good on plans of bankrupt companies. Annual premiums are \$19 for each person covered by a plan plus about 1% of the underfunding. Once the plans become underfunded, companies may face a raft of bureaucratic entanglements with the

PBGC, warns Mark Beilke, an actuarial consultant Milliman USA. For instance, they may have to give 30-day advance notice of any takeover deals.

UGLY SURPRISE. Companies struggling to cut costs by firing employees will get a nasty surprise, too. They'll have to pay out much bigger lump-sum benefits to people leaving their plans. For a 45-year-old employee, for example, the payment will be 30% higher, says Gebhardt.

Government officials say the PBGC, the Labor Dept., and the IRS are reviewing alternatives to long-bond yields, although they won't give details. Private experts say one solution would be to use a rate tied to the higher yield of Moody's Aa Corporate Index, a measure widely used to figure pension liabilities for financial reporting.

Even if government experts come up with a solution promptly, it may not be soon enough to ensure quick congressional action. "If they don't get changed in the economic stimulus bill before they go home for Christmas, it's not clear when the next opportunity is," says James Delaplane, a lobbyist for the American Benefits Council industry group. Waiting until next year would mean making any change retroactive, a messy way to legislate that would be the best muck up corporate cash-flow planning for months and at worst increase the need for economic stimulus.

By David Henry in New York

the **EURO.** **OUR** *money*

Euro banknotes will be available in denominations of €5, €10, €20, €50, €100, €200 and €500. The official symbol of the euro is €; the official abbreviation is EUR.



The countries sharing the euro:
Austria, Belgium, Finland, France,
Germany, Greece, Ireland, Italy,
Luxembourg, the Netherlands,
Portugal and Spain.

On 1 January 300 million Europeans in 12 countries will wake up to a new currency:

the euro. The euro is not new: it's been used in electronic transactions and by banks and international businesses since January 1999. But with the upcoming launch of euro banknotes and coins, one who lives, does business or is travelling in any of the 12 countries will benefit from dealing with just one currency.

There are seven euro banknote denominations, which can be recognised easily by their look and feel: the larger the banknote, the higher the value. There are also eight denominations of euro coins, each having a common side and a national side. The common side shows the value of the coin. The national side differs from country to country.

You will be able to use all euro banknotes and coins, in each of the participating countries, from 1 January when – for the first time in the history of Europe – 12 currencies will make way for just one: **the euro.** www.euro.ecb.int



EUROPEAN CENTRAL BANK

MUTUAL FUNDS

MORNINGSTAR PULLS OUT ALL THE STOPS

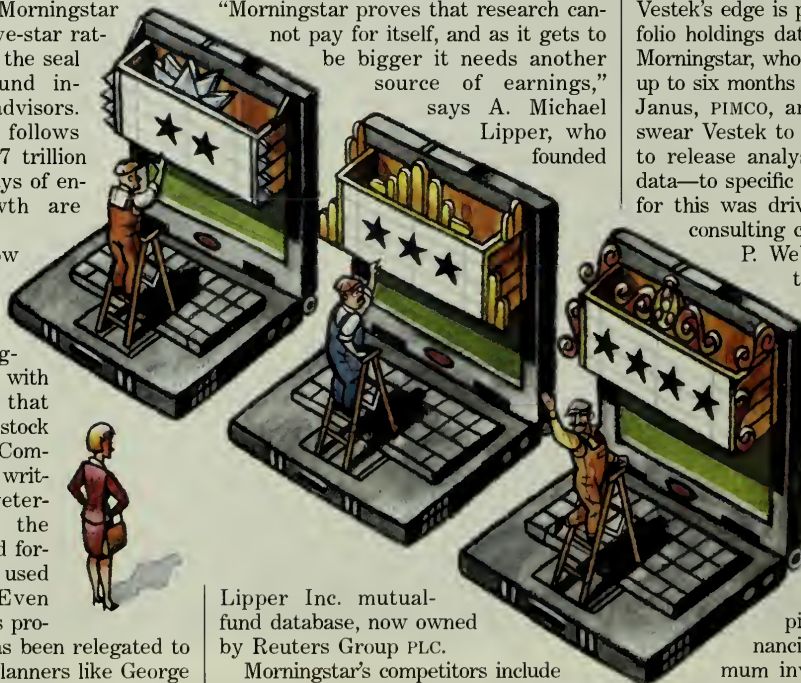
The fund-tracker is adding services—and playing catch-up

In 1984, Joe Mansueto started a mutual-fund tracking service from the living room of his apartment in Chicago's Lincoln Park. Morningstar Inc.'s reports and five-star ratings quickly became the seal of approval for fund investors and their advisors. Morningstar today follows 13,545 funds in a \$7 trillion industry. But the days of entrepreneurial growth are coming to an end.

Morningstar now faces challenges that were unimaginable a few years ago. Rivals are aggressively moving in with sophisticated tools that use more up-to-date stock and bond holdings. Competitors' reports are written by investment veterans, rather than the literature majors and former marketing pros used at Morningstar. Even worse, the company's proprietary database has been relegated to commodity status. Planners like George Paquin of Chelmsford, Mass., refuses to pay the annual \$1,000 for Morningstar's Principia, a fund database on CD-ROM, since he can get what he wants for free on the Internet. "I don't think you need to examine 100 million funds," says Paquin, who uses the likes of Kiplinger.com for fund research. "For me, Morningstar's utility has diminished."

EXPANDED OFFERINGS. With Morningstar under fire, Mansueto emerged from almost three years in semiretirement last November to get his company back on track. Profitable until 1998, it has lost money since then, partly from overspending on dot-com marketing, but expects to break even this year. The 45-year-old has unleashed advisory services and portfolio analysis products, expanded the resale of data, and is spending millions to launch a host of international Web sites to research and analyze mutual funds abroad, an invest-

ment he doesn't expect to recoup for several years. Two years ago, the company started rating individual stocks. "Morningstar proves that research cannot pay for itself, and as it gets to be bigger it needs another source of earnings," says A. Michael Lipper, who founded



Lipper Inc. mutual-fund database, now owned by Reuters Group PLC.

Morningstar's competitors include Lipper, Weiss Ratings Inc., and Standard & Poor's, like *BusinessWeek* part of The McGraw-Hill Companies. Weiss launched a rating service for equity

COMPETITION HEATS UP AMONG FUND-RATERS

MORNINGSTAR Investment advice, stock and portfolio analysis, money management

LIPPER Fund scoring system

STANDARD & POOR'S Investment advice on funds, enhanced coverage of stocks

WEISS Fund performance ratings

VESTEK Portfolio and performance analytics, including risk management

Data: *BusinessWeek*

funds in late 1998 and added bond and money-market funds late last year. The service—which originally rated banks and insurance companies—is going after do-it-yourself investors, and offers reports on the Web.

FRESH FACTS. Some fund-trackers are breaking new ground—Morningstar's original forté. For example, Vestek Select, a unit of Primark Corp., caters exclusively to pension consultants and institutional money managers until recently. It now additionally focuses on brokers and their clients, says Vestek marketing director, Susan J. Lundquist. Vestek's edge is providing monthly portfolio holdings data and analysis—until Morningstar, whose portfolio data can be up to six months old. Fund firms such as Janus, PIMCO, and American Century swear Vestek to secrecy and bind them to release analysis only—not the raw data—to specific distributors. "The need for this was driven by the investment consulting community," says Keith

P. Webster, managing director of Vestek. "They love this stuff."

Mansueto is not taking all this competition lying down. He is pushing Morningstar into money management, snapping Arthur Lutschaunig from Fidelity Investments to head up that effort. Starting this winter, he expects

to pitch the service via financial advisers. With minimum investments of \$100,000,

Morningstar will charge a management fee of 0.35% of assets, less for larger portfolios.

A bold move. But Morningstar must avoid conflicts of interest between its management and ratings business. At the investment management arena already pretty crowded. "Morningstar is trying to get into a marketplace that has too many players fighting for the little business at a time when people are in no mood to invest," argues Burton J. Greenwald, of mutual-fund consultant BJ Greenwald & Associates in Philadelphia. Still, Mansueto is excited. "This is the next step in Morningstar's evolution," he says.

Indeed. And as he strives to cope with ever-growing challenges, Mansueto will have to tap into the entrepreneurial spirit that fired him up 17 years ago.

By Pallavi Gogoi in Chicago, and Mara Der Hovanesian in New York



Mail safety: What every concerned business executive should know.

Your employees, your customers, your revenue could all be affected. What can you do to lessen the impact?

Only a few short weeks ago, opening an envelope was as natural as picking up the phone.

Today, every piece of mail is an object of suspicion. A reason to think twice.

For American business, the consequences could prove to be severe.

Mail is the circulatory system of commerce. When it slows, commerce suffers.

Unopened invoices curtail cash flow. Hampered mail centers reduce efficiency. Fear diminishes the effectiveness of direct mail.

These are just a few of the concerns on every executive's mind. Perhaps you're wondering where to turn for advice.

At Pitney Bowes, the development of secure mailing technologies has been our core competence for over 80 years. We invest more

in its research and development than any other company in the industry.

Currently, we're working with the U.S. government, as well as leading an industry task force, to improve the security of our nation's mail system.

As a company and as citizens, we believe that the single best way to undermine terror, and those who perpetrate it, is with the unwavering resolve to conduct business as usual.

To help you keep your employees and customers safe, we've published *Mail and Document Security: A Pitney Bowes Executive Advisor*. We offer it to you free of charge.

We're also available to answer any questions you may have. Call us at **1 800 672-6937** and mention Program No. 8845, or visit us at **www.security.pb.com**



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 **Pitney Bowes**

COMMENTARY

By David Fairlamb

IS 'BID-'EM-UP BRUCE' THE RIGHT GUY FOR LAZARD?

The latest twist in the saga of international investment house Lazard Frères & Co. sounds like a movie scenario: Brash, 50-something New York dealmaker (Bruce Wasserstein) takes on the challenge of a lifetime when the autocratic French patriarch (Michel David-Weill) of a 153-year-old bank hands him the reins and says: "Make this firm a powerhouse again."

The announcement on Nov. 15 that Wasserstein had taken the job as head of Lazard—after an on-and-off 15-year courtship—seemed great news for the fractious bank, whose Paris, New York, and London offices are as much rivals as partners. "Bid-'em-Up Bruce," one of Wall Street's hottest dealmakers in the 1980s and 1990s, is famous for his work on such deals as Morgan Stanley's acquisition of Dean Witter, Discover & Co., Axa's purchase of The Equitable Companies, and advising AOL on its merger with Time Warner. In January, he sold his mergers-and-acquisitions boutique, Wasserstein Perella, to Germany's Dresdner Bank for \$1.37 billion.

The word inside Lazard is that working partners are thrilled. "This guy's a financial giant," says a London partner. "He will push us back to the center of the dealmaking stage. The David-Weill era is over."

BRAIN DRAIN. Alas, the odds are slim that this screenplay will win any Oscars. Wasserstein may have a gold-plated résumé, but he has never managed an organization of Lazard's size and complexity. And Lazard, which built its name on savvy and connections, is in real danger of becoming irrelevant without a strong leader. In recent years—while its houses squabbled over fees and bonuses—top talent left, and giant investment banks that could put casts of hundreds on every deal and provide capital as well stole Lazard's business.

Getting the focus back on deals will be a big job. "Lazard is an intricate, subtle place," says a former partner. "I'm not sure [Wasserstein] has the



Without a strong leader, Lazard could end up as a small piece of a much larger bank

WASSERSTEIN: THE PARTNERS ARE THRILLED

personality needed to bring the different parts of it together effectively." Skeptics say he can be charming, but also has a large ego. Once the honeymoon is over, touchy Lazard bankers may head for the door. Wasserstein's demanding temperament and his dearth of spectacular new deals grated at Dresdner. "He didn't seem to know how to work with us Europeans," says one Dresdner executive. "We were particularly upset when he declared he would be based in London. We wanted him in New York, where we really wanted to build up business." Things soured when insurer Allianz bought Dresdner and ditched plans to float the investment bank.

It's also uncertain how Wasserstein's relationship with David-Weill, 69, will pan out. The two men say they've admired each other since 1987. Still, David-Weill

has fallen out with a series of potential successors, most recently former CEO William R. Loomis Jr., who quit last month.

There is one important difference this time. David-Weill, who effectively controls the bank through his family's 20% to 30% stake, finally yielded to rebellious senior partners and gave Wasserstein real authority, a condition he demanded. In return, Wasserstein will take a 5% to 10% stake in Lazard for \$200 million. "I have complete authority, except that he's chairman of the board and has the right to veto a merger," says Wasserstein, 53.

He could be in for a fight if he tries to reduce David-Weill's control over the bank—as close advisers say he will—by restructuring the cascade of listed holding companies with stakes in Lazard and European blue chips. Another touchy issue: Crédit Agricole. Insiders say Wasserstein wants to distance Lazard from the French bank, which rescued David-Weill from a raid by French financier Vincent Bolloré by buying Bolloré out. Crédit Agricole wants a full merger, say people familiar with both banks. Agricole won't comment. David-Weill wants to keep Lazard independent, but he sees Agricole as a counterweight to UBS Warburg, another, more aggressive holding-company shareholder.

How the story plays out will depend on whether Wasserstein gets the deals. Skeptics say he's past his peak. His last big hit was the AOL-Time Warner deal, announced in January, 2000. Even with the backing of such a deep-pocketed group such as Allianz, he wasn't able to corral much business for Dresdner. At Lazard, he'll be selling pure advice again, though most clients want capital, too. If he can't make it work, stay tuned for the sequel—in which David-Weill sells his bank to the highest bidder.



DAVID-WEILL: The chairman has veto power over mergers

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Best
Gifts

BusinessWeek Lifestyle

Come Home To Comfort Food

Our selection this year focuses on hearty, traditional fare

BY ED LEVINE

Familiar and inviting, comfort foods are what we traditionally eat at holiday gatherings. But they seem especially welcome this year in the wake of September 11, when the world suddenly began feeling so uncomfortable.

That's why in our annual holiday season search for incredible edibles, we decided to focus on American purveyors of foods that make us feel good. From meat to munchies, here are gifts you can ship that can provide warmth and solace to the people you care about.

For beef eaters, steak and potatoes are the definition of a reassuring meal. If you want to sink your teeth into a delicious hunk of meat, try the 12-ounce ribeye steaks—dry-aged for 21 days—from **AMERICAN FOOD** Conservation Beef in Helena, Mont. (table). These steaks are not only tender and flavorful, they come from cows that graze on Nature Conservancy land. That helps preserve the natural landscape by ensuring that the ranchers won't have to sell out to developers.

If a pastrami sandwich is your thing, as it is for many New Yorkers past and present, you will be pleased to know that the famous Carnegie Deli ships its peppery pastrami, rye bread, and horseradishy mustard anywhere in the country. Just follow the reheating instructions carefully. (You have to steam the meat in a large pot for a few minutes.) You can order the three pounds of pastrami sliced or unsliced.

TENDER AND LEAN. Barbecue is high atop the comfort-food list, and so is brisket. The tastiest slow-smoked brisket I ever ordered from afar came from **HUMBLE ROOTS:** Black's in Lockhart, Tex. Black's, which opened in 1932 and claims to be the oldest family-owned barbecue joint in the Lone Star State, turns out a tender, lean, and moist brisket suffused with just enough smokey flavor. Best of all, if you're having it shipped, it reheats well.

Many people have sworn off red meat, so for them a perfectly steamed lobster might do the trick. Claw lobster lobsters are cooked and flash-frozen as soon as they are trapped off Vinal-

Crunchy
pretzels, sweet
persimmons,
pie, and cider



haven Island, Me. They're then bagged and shipped on dry ice in individual slotted cardboard boxes, making it easy to cook them one at a time. I know, you're thinking precooked frozen lobsters can't possibly be as succulent and sweet as fresh ones. But these 1½-pound specimens

ghty fine. Plus, you won't have to wrestle em into the boiling water yourself. Those who snack in times of stress will find no er hard pretzels than the hand-twisted beauties m Martin's in Lancaster County, Pa. Made h flour, water, yeast, and salt, Martin's 4-inch-le pretzels are crunchy and slightly charred. ey also come in an attractive red tin that can recycled for various household uses after the agry hordes have devoured its contents. Wash down your pretzels with one-quart jugs ider from Breezy Hill Orchard in Staatsburg, Y. Elizabeth Ryan grows and presses all the it herself in a state-of-the-art cider mill on her

mented ciders contain no preservatives, so you must refrigerate them and drink immediately.

Pies are quintessentially American, and in this time of renewed patriotic fervor, I find myself dreaming about the perfect cherry pie. Lots of goopy, awful cherry pies exist in this land of ours, and then you have the magnificent cherry pies from the Grand Traverse Pie Company in northwestern Michigan. What's their secret? "We keep the cornstarch out of the pie, make flaky crusts by hand, and use the best cherries in the world, which happen to be grown in our backyard," says Denise Busley, who owns the company with her husband Mike, a California aero-

space-industry refugee. Indeed, GTPC's Old Mission cherry pies have a thin, flaky shortening crust encasing lots of Michigan cherries and virtually no syrup.

CHOCOLATE MICE. For the dieters on your gift list, how about a box of special citrus fruits grown by the Polito family in north San Diego County, Calif. Famed pastry chef Nancy Silverton of La Brea Bakery in Los Angeles swears by Polito's Satsuma mandarin oranges. They're intensely sweet and juicy. You can also order Meyer lemons, tangerines, and persimmons.

I haven't forgotten that chocolate is sometimes the only food that will do the trick in times of extreme stress. I first met Larry Burdick almost 10 years ago, when he was making chocolates for upscale restaurants in a ground-floor apartment on the Upper East Side of Manhattan. He has since moved his family to bucolic Walpole, N.H., where he now produces his hand-made creations.

His mice-shaped chocolates may look overly cutesy when you remove the top of the classy wooden box they come in, but their taste is sensational. Though I usually prefer the more intense flavor of dark chocolate, my favorite is the milk chocolate mouse filled with mocha ganache (that almost mystical combination of chocolate and cream). If you want a more intense experience, try Burdick's 3-in.-by-6-in. Harvard Square. Made of rich chocolate and walnut cake layered with creamy ganache, it's like the fudgiest brownie you've ever eaten.

Burdick also sells a hot-chocolate kit that includes a bag of chocolate and a whisk sunk into a handsome white mug and saucer. Put 2 to 3 tablespoons of the chocolate mixture into the cup, then whisk in 6 to 8 ounces of scalding milk. It's the liquid equivalent of a down comforter, a perfect beverage for our time.

TASTE TO ORDER

BLACK'S BBQ

www.blacksbbq.com;
512-398-2712

6 lbs. of brisket or
pork ribs, \$90*

BREEZY HILL ORCHARD

www.hudsonvalleycider.com; 845-266-3979

1 quart each of pear,
apple-raspberry, and
apple cider, \$12

CARNEGIE DELI

800-334-5606

3 lbs. of pastrami,
plus rye bread and
mustard, \$67.50

CONSERVATION BEEF

www.conservationbeef.com; 877-749-7177

Four 12-oz. ribeye
steaks, \$69

GRAND TRAVERSE PIE COMPANY

www.gtpie.com;
231-922-7437

One 9-in. Old Mission
cherry pie, \$19.95

LARRY BURDICK CHOCOLATES

www.burdickchocolates.com;
800-229-2419

- Box of 16 chocolate mice, \$36
- 3-in. x 6-in. Harvard Square cake, \$14
- Hot chocolate kit, \$26

MARTIN'S PRETZELS

www.martinspretzels.com; 315-628-4927

3 lbs., in decorative tin, \$29.50*

POLITO FAMILY FARMS

760-749-3674

4½-lb. box of
Satsuma mandarin
oranges, \$28

*Includes shipping



acre farm. The apple-raspberry has a wonderfully balanced, sweet, slightly acidic flavor. e pear cider is thicker, smoother, and sweeter hout being cloying. The apple cider, made exsively with crisp, sweet winesap apples, is cy and just winey enough. These nonfer-

Wake Up and Brew The Coffee

For the best cup, get great beans and that special pot

BY LARRY ARMSTRONG

THE DAILY GRIND

BLACK BEAR COFFEE

Center Tufftonboro, N.H.
800 967-3190

Starbucks is suing over its Mister Charbucks blend, \$8.60/lb.; try Original, \$8.44/lb.; or Mocha Java, \$9.48/lb.

FLYING GOAT COFFEE

Healdsburg, Calif.
800 675-3599

Top seller is Mrs. Garland's, \$9.75/lb.; half French Roast with lighter Kenyan and South American beans

PRESTOGEORGE FINE FOODS

Pittsburgh, Pa.
412 471-0133

Family roastery will customize a blend for you, or try an old favorite, the JP Hearty, \$7.69/lb.

KONA COFFEE COUNCIL

www.kona-coffee-council.com/estate.htm

Big savings on Hawaiian Kona beans. Site has links and phone numbers for more than 40 growers; \$14-\$16/lb.

With its complex mix of aromas and tastes, good coffee is like fine wine. But while wine comes out of the bottle as a finished product, beans from a bag require the right apparatus and a little effort to ensure the experience that the roaster intended.

There's plenty of equipment out there to help you in your quest for the perfect cup, from \$10 French Press pots to \$1,000 espresso machines.

Any would make a salutary gift for the coffee lover on your list (even, perhaps, for that person who makes coffee for you every morning). I've picked a few of my favorites that hew to the science of the brew.

First, get rid of those paper filters. Some can impart a slight papery taste to the coffee. Worse, they swallow up the very essence of coffee, the volatile oils that give different coffees their unique tastes. An easy fix is to use a \$10 to \$20 "permanent" gold filter from Braun or swissgold in your drip pot. Better still, try out some not-so-new ways to get a more gratifying cup from the same beans.

My favorite way to brew coffee is the vacuum pot, a.k.a. the coffee siphon. It was probably your grandmother's, too. These pots look like two glass globes, one atop the other. You put the water in the bottom one, the coffee in the top. As the water heats, it's forced into the top chamber. When you take it off the stove, a vacuum is created as the now-empty bottom part cools, and the brewed coffee is sucked back down through a plastic or glass filter. Good starter models are Bodum's original Santos, for \$40, or the slightly smaller \$36 model from Yama Glass.

Because of the constant attention that these stovetop brewers require, and their more diffi-

cult cleanup, you're not likely to use a siphon your everyday pot. They're great for entertaining or for leisurely weekend mornings when you have time to savor your java. Take a look at the \$90 Japanese Hario Nouveau, with its stovetop and alcohol burner. Another, even more expensive line is the British Cona brewer series: They start at around \$150, but they're downright elegant, if a bit scientific, on the dinner table. A good source for these hard-to-find vacuum pots is Sweet Maria's, a roastery in Columbus, Ohio (sweetmarias.com).

The best news: There's now a fully automatic siphon, Bodum's \$129 electric Santos, which has won awards for its design. Just like Mr. Coffee, it has a timer so you can set it up the night before. Starbucks has the same machine, called the Barista Utopia, and it's on sale for \$99 through the end of the year.

GROUNDS DOWN. Many roasters prefer the French Press technique because it comes closest to the way coffee is "cupped," or graded for quality.

You fill the glass cylinder with boiling water and a spoon in the coffee. After four minutes you press the plunger to force the coffee grounds to the bottom; they're trapped by a wire mesh. The most popular brands, ranging from \$20 to \$50, are the dozens of Bodum and Bonjovi models. A convenient variation is Thermos's insulated press, around \$40, which keeps the coffee hot for about an hour. You can also buy plastic presses for around \$10 that nicely fit a car's cup holders.

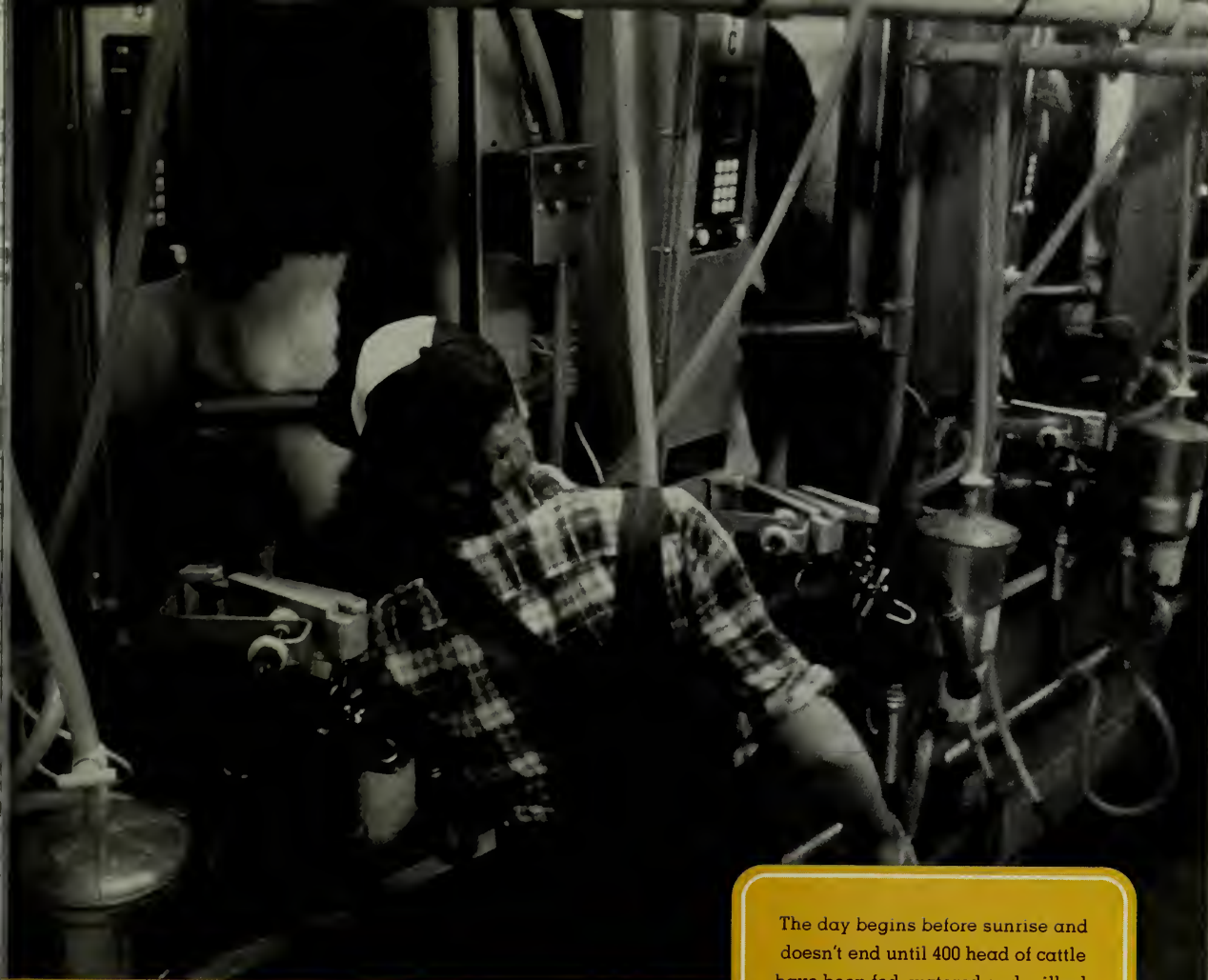
The problem with paper-free brewers

is that the coffee often leaves a powdery feel on your mouth. You can solve it with a quality grinder that grinds coffee evenly. The hottest home grinder is the new Solis Maestro, made by Baratza in Bellevue, Wash. You can get it for \$129 at Aabree Coffee (aabreecoffee.com). The \$80 Bodum Antigua and the \$99 Starbucks Barista mills are almost as good and use the same mechanism, but neither can grind fine enough for some espresso machines.

For more ideas, from espresso cups to home roasters, check out Vancouver coffee enthusiast Mark Prince's Web site, coffeekid.com. Whatever you choose, don't forget to include a couple of bags of unusual beans (table). After all, the best coffee starts with the best beans.



COFFEE



Where does he get the energy?

The day begins before sunrise and doesn't end until 400 head of cattle have been fed, watered and milked. Sure, it takes a lot of stamina to run a farm. But these days, it takes a lot of electricity as well. Today's high-tech farms use more power than ever, placing additional demands on our electricity supply. And there are even greater challenges ahead. But with government and community support, America's power companies can build the generation facilities and transmission lines our nation needs to ensure that today's farms have the energy to keep feeding America. Visit www.eei.org to learn how American progress depends on power.

electricity

America's Power Source

Have a Madeira, My Dear

The aromatic wines are making a big comeback

BY ALEX SALKEVER

It's time for dessert at Ilo, Manhattan's restaurant of the moment in the spired, neo-Gothic building that's now the Bryant Park Hotel. The cheese cart beckons, offering dozens of wheels, from biting Cabral blue cheese to milder, nut-scented Roncol sheep's-milk rounds. Perhaps a glass of hearty port to go with the *fromage*?

Not a chance. At Ilo, the bias is toward the other Portuguese after-dinner delight. That would be Madeira, sweet white wines fortified with brandy and named for an island off the coast of North Africa where they are crafted. On any given night, Ilo offers over a half-dozen vintage Madeiras, ranging from a 1795 Barbeito Terrantez redolent of honey and vanilla (\$225 per glass) to a fruitier 1944 Malvasia Quinta da Piedade (\$28 a glass).

The wine of choice in America until the mid-19th century, Madeira is making a comeback, thanks to hot restaurants from Gotham to San Francisco. "It's seeing a resurgence as people start to appreciate both rare wines as well as a nice after-dinner drink," says David Parker, CEO of Brentwood Wine, a West Linn (Ore.) rare-vintage online auction house.

Madeira follows on the heels of port, cigar's longtime companion and now a staple on dessert menus. Unlike port, Madeira is lighter and won't overpower frothy desserts. It's also far less pricey than port of comparable quality and lasts longer (table). Indeed, the wine can keep for a

year or so after it has been uncorked.

Madeira's lightness doesn't mean it's short on complexity and richness. Classic vintages can have dozens of overtones, including citrus and raisins. Even younger Madeiras of blended vintages delight the palate.

Indifference to the wine in the U.S. belies its history. Because the island was the final landfall before passage to America, ships would load up on Madeira's wines, both as a

product to sell and to use as ballast. Vintner found that the searing heat in the ships' hold improved the wines. So they sent casks to arrive fro across the seas, sometimes for several voyages. They also fortified Madeira with brandy to further preserve it and add complexity.

Today the slow-cooking technique, known as *estufagem* (derived from the Portuguese word for hothouse), is done on land. The finest Madeira

are heated naturally by placing casks under the eaves of a roof to bake in the semi-tropical sun. Winemakers cook less

er varieties in casks stored in heated rooms or steel vats warmed by hot water pipes or heating coils. Temperatures of the wines easily exceed 115°F as they cook from three months to a year.

CARAMEL. Four types of Madeiras, each named for a varietal grape, predominate. Sercial, aged at least eight years, is the driest and is imbibed chilled as an aperitif or with fish or salad. F. cakes, fruits, and mellow cheeses, Verdelho Madeira offers a bit more sweetness. Bual, several notches up the richness scale, is often served with creamy desserts. The richest is Malms (also called Malvasia), a caramel-toned powerhouse best savored as an after-dinner drink.

Madeiras also are classified as either vintage or nonvintage. Vintage Madeiras, made from grapes picked in a single year, must age a minimum of 20 years in the cask and 2 in the bottle before they are sold. Only several thousand cases are produced a year, so vintage Madeiras are pricey, ranging from \$60 to \$90 a bottle. Offerings older than 100 years can fetch thousands of dollars. Nonvintage Madeiras, meanwhile, blend different pressings of wine, none younger than the declared age on the bottle. They must be aged at least three years after they've been blended before they can be sold.

Madeira is still mostly made on the island after which it's named, by fewer than two dozen wineries, notably Barbeito, Cossart Gordon, and Lea & Co. Fortunately, major wine stores in the U.S. carry it, and good nonvintage bottles in the 10- to 15-year range can be had for \$15 to \$40. Five-year-old nonvintage Madeiras work nicely as dried wines, but experts say 10 years is where the real fireworks start. Vintage or not, you can expect more pyrotechnics as more Madeiras make it onto menus and shop shelves.



SWEET ON MADEIRAS

While vintage Madeiras are rare and costly, younger, nonvintage wines, such as the ones below, are well-priced and easy to find

WINE

BARBEITO 10-Year
Verdelho Madeira NV

BROADBENT 10-Year
Malmsey Madeira NV

HENRIQUES & HENRIQUES
Bual Madeira
10-year-old NV

HENRIQUES & HENRIQUES
Sercial Madeira
10-year-old NV

PRICE/COMMENTS

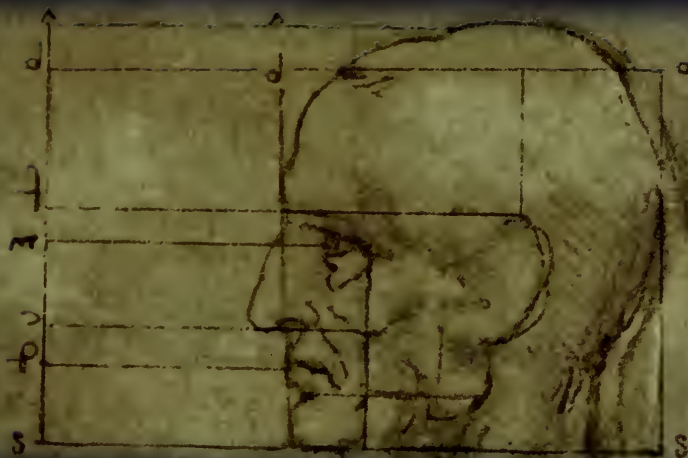
\$18/Less dry but zippy,
with fruity overtones

\$28/Rich, honeyed, and
smooth, with little acidity

\$35/Sweet and powerful
enough to face down
chocolate

\$35/Long, clean finish
with a bit of a tang at
the end

INVESTOR DILEMMA #1: BRAINS DON'T COME WITH OPERATING INSTRUCTIONS.



Unfortunately, there are no good instructions for how our brains will operate when emotions take over – especially in an uneasy market. But value investing is an approach that takes out the emotion and takes advantage of opportunities created by market swings. Because when investors overreact, good companies can become good bargains – if you know how to spot them. And Scudder's value team does. With analysts and partners worldwide. Ask a financial advisor how value investing can help you. Call Scudder Investments at 1-800-621-1048. Or visit www.scudder.com. And save something rare in today's market. Your sanity.

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'Tis the Season For Closed-end Funds

Bargains often abound as investors dump dogs

BY ANNE TERGESEN

One of the few near-certainties of the stock market is that every December, many closed-end funds get cheap. That's because investors dump losers to take tax losses before yearend. "I can't recall a year where December hasn't been the best time to buy closed-end funds," says Thomas Herzfeld, whose Miami investment firm specializes in them.

Many closed-ends—vehicles that invest like mutual funds but are bought and sold like stocks—get so cheap, in fact, that buyers get "a very good risk-reward relationship," says Herzfeld. The funds typically rebound in January as investors come back to the market to reallocate assets and establish new positions. Their recovery can provide a windfall—say, 20% in only a month, adds Herzfeld.

WIDEST DISCOUNT. Closed-end funds have a unique structure. They issue a fixed number of



shares. So if demand for a fund heads south, its share price will, too—even if the portfolio's value holds steady. That's precisely what happens when tax-conscious shareholders sell: The share price swoons, but the net asset value (NAV) remains unchanged, since the selling isn't related to the fund's holdings, says Jon Maier, closed-end fund analyst at UBS Warburg. In contrast, mutual funds create new shares when money comes in and redeem them when investors cash out. And they do both transactions at NAV—or what their assets are actually worth.

For a variety of rea-

sons, closed-end funds tend to trade at a price that's a discount to the value of their holdings. At yearend, that discount usually reaches its widest point.

This year, the pattern of widening discounts may be less pronounced, however. Because of the bear market, investors may not have as many taxable gains to offset and may be less motivated to chalk up losses by selling closed-end losers. Moreover, many of the municipal and investment-grade bond funds that comprise about half of the closed-end universe are poised for gains in 2001.

Still, some tax-loss selling is sure to take place. After all, even without gains, investors can deduct up to \$3,000 in capital losses from their ordinary income. Losses in excess of that are carried forward to offset future

years' gains. Funds are likely to be hit by tax-related selling of those investing in U.S. stocks, foreign stocks, and high-yield bonds. All three sectors have been hammered this year.

Herzfeld says good prospects can be found among a fund's year's worst performers (table). "I don't buy until after

see a fund's discount widen. The data are widely published at the end of each week, but you always contact the fund for the latest numbers. And many, though not all, closed-end NAVs are available daily at www.nasdaq.com. (Enter the ticker symbol bracketed by X's. For example, Alliance All-Market Advantage's AMO becomes XAMOX.) To make sure investors didn't flee because of portfolio problems, check that NAV has been steady even as the share price fell.

One good example is the mevc Draper Fisher & Jurvetson Fund, which invests in private, high-tech technology companies. Tax-loss selling pushed its discount to 47% last December, luring investors to buy \$1 of assets for 53¢. In January, the share price rebounded, and the discount narrowed to 29%. Those who rode the discount earned a cool 35% in just one month—and Herzfeld thinks the fund has a good chance of repeating that performance next year.

Although some high-yield bond funds are good candidates for tax-loss selling, be wary. Many trade at premiums to their NAVs—not because of strong demand but because the underlying bonds have fallen further in price than the shares of the fund. With default rates still high, the fund's NAVs and dividends may be at further risk, says Dennis Emanuel, a closed-end analyst at PricewaterhouseCoopers. "I'm a fan of Tomolomon Smith Barney. Why take chances with high-yields when you can make easier money with beaten-up closed-end equity funds?"

Buying Opportunities?

FUND (SYMBOL)	2001 MARKET RETURN	DISCOUNT TO NET ASSET VALUE
EUROPEAN WARRANT (EWF)	-57.5%	-17.5%
LCM INTERNET GROWTH (FND)	-39.2	-12.8
ENGEX (EGX)	-45.0	+1.5**
Z-SEVEN (ZSEV)	-39.9	-0.2
NEW GERMANY (GF)	-32.4	-20.9
CORNERSTONE STRATEGIC VALUE (CLM)	-25.9	-14.0
FRANCE GROWTH (FRF)	-26.6	-14.0
ALLIANCE ALL-MARKET ADVANTAGE (AMO)	-23.8	-0.9
ADAMS EXPRESS (ADX)	-23.6	-11.1
ITALY (ITA)	-24.4	-13.7

*Trades at a premium

Returns as of Nov. 16

Data: Thomas J. Herzfeld Advisors



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WHEN HE'S RETIRING BUT SHE ISN'T



BY TODDI GUTNER

hers@businessweek.com

A big age difference makes financial planning tougher for couples, especially if they have kids. But a few key adjustments should do the trick

My husband is 53, and I am 10 years younger. During our 20-year marriage, I have been in and out of the workforce raising children and getting my PhD in economics. Now, I plan to return to full-time employment. I am essentially just getting my career under way as my husband approaches the completion of his. None of the retirement seminars address the issue that not all husbands and wives are the same age, nor do they retire at the same time.

—e-mail from Worcester, Mass.

Couples with a wide age gap face a unique set of problems as they plan for retirement. They must often set aside the conventional wisdom about how much insurance they need, what they should invest in, and how to calculate their pension payouts. "Seldom do people have the same needs at the same time, but it's even harder to plan when there is a big age difference," says Deena Katz, a certified financial planner in Coral Gables, Fla.

A husband and wife approaching retirement might normally scale back their life insurance, especially if their kids are college age or older. But if the family will be depending on the income of the younger, still-working spouse, that would be a reason to increase his or her life insurance.

Spouses with big age gaps must also make decisions about how to manage their pension money much earlier than couples who are the same age. With a younger spouse, the couple might have higher costs for a longer period of time, and their investment strategy must reflect that. "Couples must design their portfolio around their anticipated cash-flow needs, and then decide how to fund the expenses," says Stanley Ehrlich, a registered investment adviser in Clinton, N.J.

The husband in the Worcester (Mass.) couple has worked for 27 years as a computer-systems analyst at the same manufacturing company and is looking to retire within the next five years, while the wife is hoping to continue rising through the administrative ranks at the university where she works. They have paid off their mortgage and saved enough money through the husband's 401(k) to pay for college for their kids,

ages 13 and 17, or retirement—but not both.

They hope to meet both financial goals by using the wife's salary to cover college costs and the husband's retirement funds to pay for day-to-day expenses. To protect her income, she will need to increase her life and disability insurance at the same time her husband decreases his. Now, she has no disability, and he gets covered through his job that protects 66% of his salary. They have \$220,000 worth of life insurance, divided equally, but they will have to shift the balance in her favor.

Fortunately, health insurance will not be an issue because the wife's policy will cover the husband until he qualifies for Medicare at age 65. They do both need to consider purchasing long-term care insurance, however.

STAY IN STOCKS.

For their investment strategy, "they need to allocate their portfolio for the overall total return," and that means a high proportion of stocks, says Ehrlich. The wife must consider how long she intends to work and contribute the maximum amount to her existing retirement account. She plans to invest more aggressively than her husband—at least in stocks. He has recently switched some

money out of equities, and now more than half his portfolio is in bonds.

When it comes to his pension payout, the husband should keep his 401(k) money in the company plan, even though he could move it to a rollover IRA. Why? Retirees from 55 to 59½ can withdraw from company plans at will and without penalties. With a rollover IRA, a retiree younger than 59½ must adhere to a strict withdrawal plan or get hit with penalties.

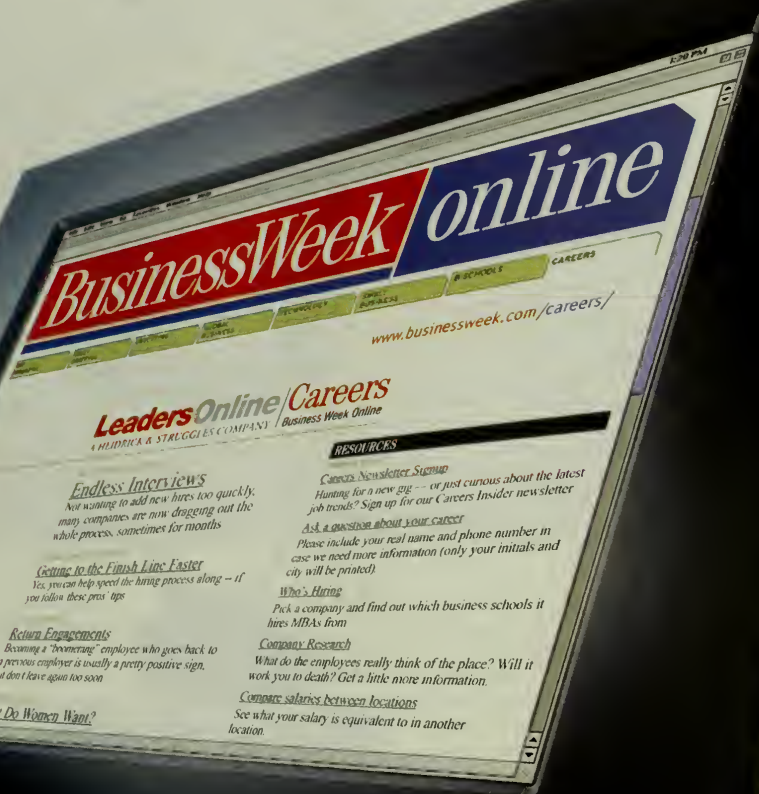
With his wife still working, the husband shouldn't have to draw down all his retirement stash. What's left when he's 70½ will be subject to the Internal Revenue Service's new distribution rules that take effect on Jan. 1. These rules will work to the advantage of spouses who are at least 10 years apart, says Sue Stevens, a certified financial planner in Deerfield, Ill. They can choose a payout schedule that allows them to set up a withdrawal plan based on an average of their life expectancies instead of just his, which is now the case. That allows the money to last longer and provide comfort for anyone in this situation.



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THE RIGHT PRICE FOR THE NEW PRU



BY ROBERT BARKER

rb@businessweek.com

A "demutualized" Prudential isn't going to be a killer company. But if the IPO shares are cheap enough, they could be a decent bet in this bear market

It's hard to imagine worse timing. Nearly four years since Prudential Insurance set out to transform itself, "the Rock" is due any day now to sell stock in an initial public offering. Led by Goldman Sachs, the deal figures to raise \$3 billion, making it one of this dismal year's biggest. More important to Prudential's 11 million policyholders, the IPO will turn most of them into investors as the insurer "demutualizes," or changes from a mutual company owned by customers into an investor-owned, publicly traded company going by the name Prudential Financial.

If demutualization—the word itself is odious—weren't head-spinning enough, Pru is coming to market with a wide-ranging notion of its own value. Pru executives are keeping quiet ahead of the deal. But their filing with the Securities & Exchange Commission suggests a range as wide as Gibraltar, from \$25 a share to \$30 a share. This tells me that initial trading will be relatively inefficient and may—just may, in this bear market and cloudy climate for insurers—offer investors an unusual opportunity.

That's why I have worked up a little something I call the Prudent-O-Meter. It's a gauge of the opportunity, and danger, presented by Prudential's IPO:

■ **At \$30 or higher.** Wall Street often values insurance and many other financial-services companies on multiples of their equity, or book value. At \$30 a share, Prudential would sell for 0.83 times book value. That's a steep discount to such premier names as American International Group (4.4 times book) or even Merrill Lynch (2.1 times). It's even below Pru's most comparable rival, MetLife (1.2 times). Yet Pru shapes up poorly next to Met. It's smaller by sales and earnings while suffering far narrower profit margins and a much higher load of debt (table). Buy Pru at \$30 or above? Prudent-O-Meter says: only if you've got rocks in your head.

■ **At \$27.50.** If Pru settles for a price at the midpoint of its range, its price-book ratio shrinks to 0.75. In the ballpark, maybe, if you have reason to be confident that Pru can make good on

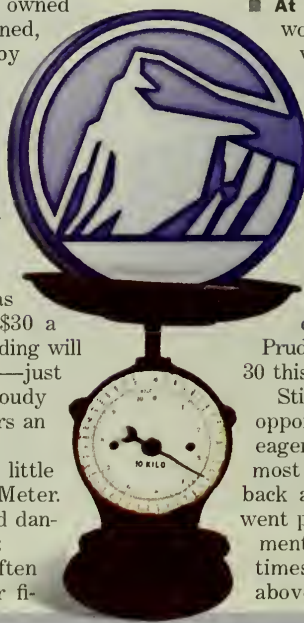
its aspiration "to be a worldwide financial services leader in both the growth and protection of our clients' assets."

So I searched the fine print in Pru's filing for confidence-builders. It does aim to cut \$500 million in annual operating costs. Beyond that, mostly found signs of mediocrity. Pru is the No. 16 brokerage firm, the No. 16 property-casualty insurer, the No. 23 mutual-fund manager. Even its core, life insurance, Pru is the U.S. rank only No. 3 in sales to individuals. The world already is stacked with heavyweights lunging after the same prize, from AIG and AXA to ING Group and Citigroup. Pru at \$27.50? P-O-M says you are an optimist, the sort who bets cash money on a career .220 hitter breaking .300 next season.

■ **At \$25 or below.** Here, Prudential would go for less than 0.7 times book value. Pru obviously is not my idea of a killer company. Yet no other big U.S. financial stock goes that cheap. Yes, there are questions. The biggest is simply whether Pru can deliver profits that do depend, as they have so heavily in recent years, on such unpredictable sources as growth in its own pension-fund assets. Pension-fund credits, for instance, accounted for \$346 million, or 25%, of Prudential's pretax profit through September 30 this year.

Still, Pru at \$25 or less could offer an opportunity to exploit management's eagerness to demutualize, perhaps at most any price. P-O-M's needle points back at the historical record: MetLife went public in April, 2000—another moment of market agony—at under 0.5 times book, or \$14.25 a share, just above the bottom of its estimated price range. Since then, it has not traded lower.

Despite my great confidence in the Prudent-O-Meter, it cannot gauge one unavoidable risk. Prudential expects 4 million of its policyholders to wind up with fewer than 100 shares in the new public company. The plus the rest of Pru's policyholder-investors, will be free to dump a collective 456 million shares, 81% of the total outstanding, at any time. Imagine Pru's stock price millions of those hit the market at the same time. Might be like the British trying to float the Rock of Gibraltar



WEIGHING THE ROCK

	PRUDENTIAL PRU*	METLIFE MET
REVENUES	\$26,994	\$32,400
NET INCOME	84	1,360
TOTAL DEBT	13,062	3,053
BOOK VALUE	20,554	16,928
MARKET VALUE	16,989	20,098
PRICE-BOOK VALUE RATIO	0.8	1.2

* Tentative symbol
Dollars in millions. Income statement data are for 12 months ended Sept. 30; balance sheet items as of Sept. 30; Prudential's market value assumes \$30 IPO price, and book value is pro forma post-demutualization and IPO; MetLife market value is as of Nov. 15.

Data: Company reports, BusinessWeek

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Column

we generate promise.



We have all made promises. Spoken. Unspoken.

We may have stood over our sleeping children and said silently,
"I will give you better than I was given.

I will make a clean path to take you forward.

I will help make this world a better place."

At Duke Energy, we share this promise with others around the world.

We are 23,785 people with families, who love, live, raise children, and hope for the future.

And all of us have committed to be leaders —

creative thinkers, careful planners, and honest partners.

But, most of all, we have vowed to be true to our word and to ourselves —

to be keepers of promises.



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any way you want



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GENE G. MARCIAL

media giant
ks ripe for a
out, say some.
J.P. Morgan Chase
sitting pretty
the recovery.
EDGAR is the place
go for SEC info
r the Net

Cablevision Systems (CVC) has been a loser all year, tumbling from 75 in mid-January to a low of 33 on Nov. 2. That was about when some hedge funds started buying, pushing CVC up to 37 by Nov. 20. Behind the uptick: Some say it was ripe for a turnaround on fundamental and technical grounds. Others see Cablevision as buyout bait—worth \$10.6 billion, or \$60 a share. A cable operator in seven states, Cablevision owns several cable-TV networks, including Bravo, American Movie Classics, and sports channels, through its Rainbow Media Group unit. It also owns Madison Square Garden, Radio City, and retailer the Wiz.

If Cablevision's stock breaks 38, it will be the first time in eight months that CVC has climbed above its 10-month trading range. "It would be the first positive sign that the stock is bottoming and on its way up," says Andrew Addison of Addison Investment Management. In fundamentals, the outlook is similar: Cablevision's business has "reached its low-water mark, and it's at a turning point toward stronger operating performance in the next 12 to 24 months," says analyst Lara Warner of Lehman Brothers. She rates the stock a buy, with a 12-month target of 45, based on a sum-of-the-parts valuation.

A global money manager with close ties to Cablevision says she's been buying Cablevision shares for just one reason: takeover appeal. This pro says a major U.S. media company and a European conglomerate are "pursuing" Cablevision, whose cable-TV and other media assets would fit well with theirs. Analyst Robert Rout of Arnhold & S. Bleichroeder says there are plenty of buyers for Cablevision's "attractive assets." Although he's unaware of any possible deal, Rout says in a buyout, Cablevision is worth 81 to 91 a share. Cablevision declined comment as a matter of policy.

GOING CHEAP AT J.P. MORGAN CHASE

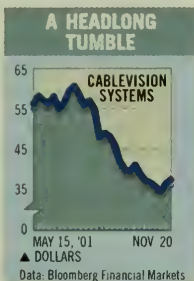
Investors who foresee a turnaround next year are beefing up their portfolios with recovery-play stocks. For John Maloney, the top pick is J.P. Morgan Chase (JPM), with total assets of \$715.8 billion and a market cap of \$78.7 billion. Formed by the merger approved early this year of Chase Manhattan and J.P. Morgan, the combined company is a "solid value play on the recovery of the economy and the capital markets," says Maloney, president of M&R Capital Management. He points out that Morgan Chase's prospects are

much tied up with investment banking, which accounts for 50% of revenues and 70% of operating earnings. As such, exposure to credit risks on loans has been reduced, he says, with J.P. Morgan Chase using its credit relationship with clients as a lead-in to investment banking deals.

J.P. Morgan Chase, at 39, trades at a discount: That's just 11 times Maloney's 2002 earnings estimate of \$3.25 a share, vs. 15 times for its peers. Maloney thinks J.P. Morgan Chase also deserves a price-earnings ratio of 15—implying a price of 49 or 50. If the recovery is robust, J.P. Morgan Chase could earn \$3.30 a share or more, he adds. For 2001, he sees earnings of \$2. Diane Glossman of UBS Warburg, who rates the stock a buy, agrees that, at 12 times her 2002 estimate of \$3.30, the stock is at a considerable discount.



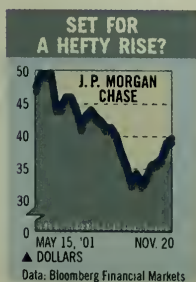
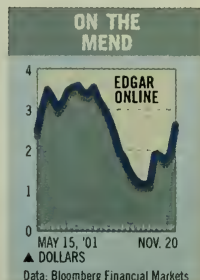
MALONEY: It's a "solid value"



EDGAR TIES THE KNOT WITH THE SEC

How many companies could say the Securities & Exchange Commission was their friend? EDGAR Online (EDGR) certainly can. EDGAR (electronic data gathering, analysis, and retrieval) is tops in the business of getting information filed with the SEC off the Net quickly. Here's the scoop: In about a week, the SEC will start referring anyone seeking SEC documents to EDGAR. The SEC has signed a contract for EDGAR to provide such info free of charge. But for more detailed data, there's a fee. "This new situation will double our traffic and ultimately our revenues," says EDGAR Chairman Marc Strausberg. EDGAR has 800,000 registered users. Of those, 20,000 individuals and professionals already pay \$20 a month for specialized services, and 660 corporations fork over an average \$2,400 a month. EDGAR's biggest client: Nasdaq, which pays \$5 million a year. Reuters, which owns 4% of EDGAR, pays \$1 million a year.

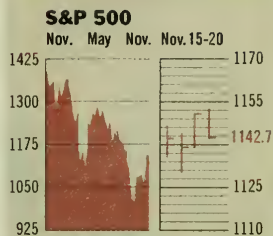
Michael Smith of Fahnestock, who rates EDGAR a buy, says it has done a good job of moving toward profitability. EDGAR posted a 100% jump in third-quarter revenues. He sees a slight loss or breakeven this year and earnings of 13¢ a share in 2002. Smith sees EDGAR, now at 2.69 a share, doubling in 12 months. Down the road, he says, EDGAR might be acquired by a large media or information outfit.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Equities fell on Nov. 20 as investors took profits after weeks of rising markets. Leading the decline was the Nasdaq, which shed 2.8%, followed by the Dow Jones Industrials, down 0.8%, and the S&P 500, off 0.7%. Earnings worries again roiled the tech sector: Teradyne and Applied Materials were down 6.3% and 5.6%, as was chip giant Intel, off 3.4%.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

		% change		
		Year to date	Last 12 months	
U.S. MARKETS				
S&P 500	Nov. 20	Week		
S&P 500	1142.7	0.1	-13.5	-15.2
Dow Jones Industrials	9901.4	0.8	-8.2	-5.7
Nasdaq Composite	1880.5	-1.2	-23.9	-34.6
S&P MidCap 400	479.9	-0.1	-7.1	-2.9
S&P SmallCap 600	214.9	0.2	-2.2	3.6
Wilshire 5000	10,523.1	0.1	-13.6	-14.9
SECTORS				
BusinessWeek 50*	741.1	-1.1	-23.6	-29.5
BusinessWeek Info Tech 100**	408.2	-1.0	-27.8	-42.2
S&P/BARRA Growth	593.1	0.2	-13.7	-20.5
S&P/BARRA Value	549.1	0.0	-13.7	-9.8
S&P Energy	789.0	-0.2	-15.3	-14.9
S&P Financials	145.8	-0.6	-11.5	-1.3
S&P REIT	91.2	0.4	3.7	11.4
S&P Transportation	671.4	2.4	-3.8	-1.4
S&P Utilities	246.4	-1.1	-29.7	-25.8
GST Internet	97.6	-3.1	-46.3	-61.4
PSE Technology	659.8	-1.4	-19.0	-25.6

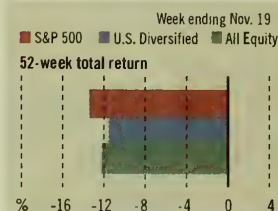
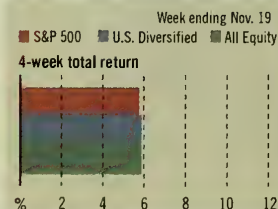
*Mar. 19, 1999 = 1000 **Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS	Last month %	Last 12 months %
Communications Equip.	21.7	Specialty Printing 50.6
Hotels & Motels	20.5	Paper Containers 49.7
Airlines	19.8	Metal & Glass Containers 48.9
Entertainment	19.5	Toys 45.9
Semiconductors	18.9	Furnishings & Appliances 40.9

		% change		
		Year to date	Last 12 months	
GLOBAL MARKETS				
S&P Euro Plus (U.S. Dollar)	Nov. 20	Week		
S&P Euro Plus (U.S. Dollar)	1063.2	1.4	-2.9	
London (FT-SE 100)	5298.7	1.1	-1.4	
Paris (CAC 40)	4593.5	0.4	-2.9	
Frankfurt (DAX)	5096.2	2.9	-2.0	
Tokyo (NIKKEI 225)	10,575.6	4.8	-2.3	
Hong Kong (Hang Seng)	11,225.8	2.5	-2.4	
Toronto (TSE 300)	7381.2	0.4	-1.7	
Mexico City (IPC)	5699.2	-0.9		
FUNDAMENTALS				
	Nov. 19	Wk. ago		
S&P 500 Dividend Yield	1.36%	1.37%		
S&P 500 P/E Ratio (Trailing 12 mos.)	46.2	45.2		
S&P 500 P/E Ratio (Next 12 mos.)*	22.0	21.7		
First Call Earnings Revision*	-3.81%	-6.55%		
TECHNICAL INDICATORS				
	Nov. 19	Wk. ago		
S&P 500 200-day average	1187.2	1191.5		
Stocks above 200-day average	48.0%	45.0%		
Options: Put/call ratio	0.58	0.70		
Insiders: Vickers Sell/buy ratio	1.01	1.35		

WORST-PERFORMING GROUPS	Last month %	Last 12 months %
Natural Gas	-17.4	Communications Equip. 17.4
Photography/Imaging	-12.7	Natural Gas 12.7
Engineering & Constr.	-10.2	Instrumentation 10.2
Gold Mining	-9.7	Defense Electronics 9.7
Defense Electronics	-7.1	Computer Systems 7.1

Mutual Funds



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders			
Technology	15.9	Precious Metals	28.8
Pacific/Asia ex-Japan	14.2	Real Estate	14.3
Diversified Emerging Mkts.	10.6	Small-cap Value	13.6
Communications	10.4	Financial	10.2
Laggards			
Natural Resources	-2.8	Technology	-43.4
Utilities	-0.9	Communications	-40.4
Japan	-0.1	Japan	-33.5
Precious Metals	0.7	Diversified Pacific/Asia	-25.3

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders			
ProFunds UltraOTC Inv.	34.7	Schroder Capital Ultra Inv.	77.7
Black Oak Emerging Tech.	30.8	CGM Focus	60.8
Potomac Internet Plus	28.6	Potomac Internet Short	58.8
Investec internet.com Index	28.2	Burnham Financial Svcs. A	46.0
Laggards			
ProFunds UltraShort OTC	-29.3	ProFunds UltraOTC Inv.	-78.1
Rydex Dynamic Vent. 100	-28.0	Berkshire Focus	-73.8
Potomac Internet Short	-20.4	Berkshire Technology	-73.5
Rydex Arkto Investor	-15.5	Merrill Lynch Focus 20 B	-71.9

Interest Rates

KEY RATES	Nov. 20	Week ago
MONEY MARKET FUNDS		
	2.26%	2.34%
90-DAY TREASURY BILLS		
	1.93	1.86
2-YEAR TREASURY NOTES		
	2.94	2.68
10-YEAR TREASURY NOTES		
	4.87	4.52
30-YEAR TREASURY BONDS		
	5.31	5.02
30-YEAR FIXED MORTGAGE†		
	6.56	6.47
†BancQuote, Inc.		
BLOOMBERG MUNI YIELD EQUIVALENTS		
Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.		
	10-yr. bond	3
GENERAL OBLIGATIONS		
	4.06%	
TAXABLE EQUIVALENT		
	5.88	
INSURED REVENUE BONDS		
	4.27	
TAXABLE EQUIVALENT		
	6.19	

THE WEEK AHEAD

CONSUMER CONFIDENCE Tuesday, Nov. 27, 10 a.m. EST ► The Conference Board's consumer confidence index for November likely inched higher, to 86, from 85.5 in October. That's according to the median forecast of economists surveyed by Standard & Poor's MMs, a division of The McGraw-Hill Companies.

EXISTING HOME SALES Tuesday, Nov. 27, 10 a.m. EST ► Sales of existing homes in October probably remained unchanged at an annual rate of 4.9 million units.

BEIGE BOOK Wednesday, Nov. 28, 2 p.m. EST ► The Federal Reserve Bank will release its collective reporting of regional economic activity in advance of the policy meeting scheduled for Dec. 11.

DURABLE GOODS ORDERS Thursday, Nov. 29, 8:30 a.m. EST ► New orders for durable goods probably rose 0.9% in October, after plunging 8.5% in September.

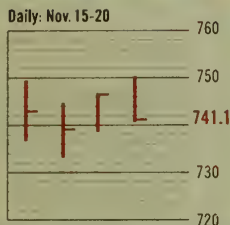
NEW RESIDENTIAL SALES Thursday, Nov. 29, 10 a.m. EST ► New single-family home

sales in October are forecast to have risen to an annual rate of 854,000, slipping to 864,000 in September.

GROSS DOMESTIC PRODUCT Friday, Nov. 30, 8:30 a.m. EST ► The Commerce Department's second pass at third-quarter economic growth is expected to show that real GDP contracted at a 0.6% annual rate, from the initially reported 0.4% decline. Aftertax corporate profits likely dropped 6.4% during the third quarter, after falling 1.7% over the second quarter.

BusinessWeek Fifty

THE
BUSINESSWEEK **50**

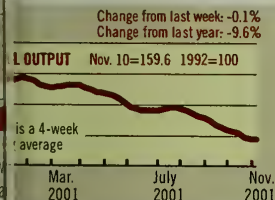


It fell 1.1% for the week ended Nov. 20, after a two-week run. The list was hurt by weakness in the tech sector. Xilinx, Analog Devices, and Texas Instruments lost 13.3%, 10.1%, and 7.8%, respectively. Dynegy, down 9.7%, as investors worried that its acquisition of troubled Enron would fall through. The only bright spot was a bright spot, rising 7.3% for the week.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	1.3	5.0	26	Verizon Communications	-0.1	1.6
Petroleum	-1.5	-14.5	27	Citigroup	-1.8	1.8
	-7.5	-42.7	28	Sun Microsystems	0.2	-34.0
	-9.7	-11.1	29	Merck	-1.2	-19.6
Materials	-10.0	-19.1	30	El Paso	-0.2	-29.9
Financial	-12.8	-93.5	31	Altera	-7.5	-9.9
Petroleum	0.4	4.5	32	Marsh & McLennan	0.9	1.4
	-1.8	-20.2	33	Household International	-4.2	-0.1
Energy	0.3	-16.9	34	ChevronTexaco	-0.1	-0.4
	-2.4	-31.9	35	SBC Communications	4.4	-14.1
Brothers Holdings	-1.6	2.7	36	Mercury Interactive	-0.4	-47.6
	3.6	-62.5	37	ADL Time Warner	-3.3	-16.0
	16.3	-68.2	38	Washington Mutual	3.7	-2.2
Laboratories	7.3	8.6	39	General Dynamics	4.0	23.3
Financial	-1.6	-10.4	40	Comcast	2.6	-10.3
Technology	-6.1	-27.4	41	Morgan Stanley Dean Witter	-2.3	-10.6
	-13.3	-21.0	42	Tellabs	5.1	-62.9
Hess	0.9	-20.5	43	Exxon Mobil	-1.9	-6.7
Argy	0.1	-8.5	44	Scientific-Atlanta	2.9	-47.4
Communications	0.6	-57.3	45	U.S. Bancorp	-0.2	-21.7
Financial	-6.2	-8.4	46	Paychex	-3.4	-10.3
Petroleum	2.4	2.3	47	Merrill Lynch	-0.1	-13.6
Services	-10.1	1.9	48	Bed Bath & Beyond	0.1	26.8
Resources	1.3	-21.1	49	Texas Instruments	-7.8	-3.5
Health	5.2	3.4	50	Teradyne	-5.2	-15.9

Production Index



The index was down slightly in the latest week. The calculation of the four-week moving average rose to 160.6, from 159.8. After seasonally adjusted, trucks and autos rose sharply, even as *Time Reports* reported capacity utilization year basis fell for a fifth straight quarter. Oil refining, and rail-freight traffic also rose. Electric power and coal were down, but production was unchanged.

Each of the index components is at www.businessweek.com.
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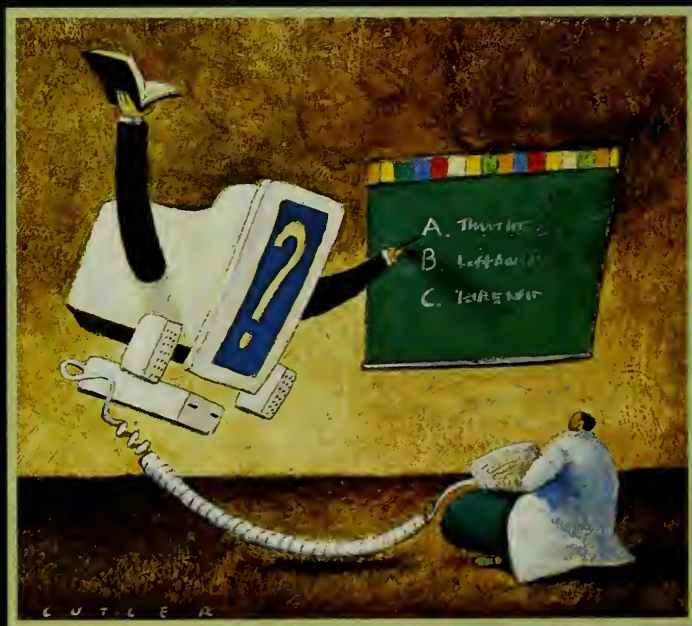
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Index to Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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CONGRESS: TIME TO TAKE A STAND

Here's an idea: Throw all the lobbyists out of Washington for the duration of the war against terrorism. It's bad enough seeing special interests dominate the U.S. political system in times of peace, but the spectacle of lobbyists pleading for their clients under the guise of national security is unseemly at best, and perhaps even repellent. It's simply unacceptable to see lobbyists waving the flag to get a piece of the emergency economic stimulus bill for their clients. Corporate America would do well to show restraint in this moment of national crisis.

Take the insurance industry, for whom September 11 is proving a bonanza. Companies are raising rates 20%, 50%, even 100% on some lines of industrial and commercial insurance, even as their lobbyists press to get the government to pick up most of the claims from future terrorism. True, insurers may pay out \$40 billion to \$70 billion in claims related to the World Trade Center attacks. But they have \$300 billion in capital and are busy raising more—a sign that, even in the face of the most terrible disaster, they are financially sound. To raise rates by the amounts being contemplated, while asking government to bear much of the risk, is unjustified.

Alas, the insurance industry isn't alone in mining for disaster gold. Partisanship runs rampant on both sides of the congressional aisle, and politicians seem to be fighting to

satisfy loyal political constituencies, not help the country whole. Many narrow tax cuts and spending programs are normally proposed when the nation was at peace and are being recycled as wartime necessities.

For example, companies are lobbying hard for the abolition of the corporate alternative minimum tax, claiming that it would stimulate the economy and boost earnings. Moreover, some companies are pushing for retroactive refunds of payments for past years, which would cost billions of dollars. But neither change would boost growth, since neither refund of past AMT payments or elimination of future minimum payments would give corporations much of a reason to increase investment.

On a smaller scale, other special interests have taken advantage of the opportunity to load their self-interested tax cuts into stimulus bills. One provision in the Senate bill would extend a tax credit, due to expire this year, for electricity produced from wind, biomass, and even poultry litter. Financial-services firms are looking to extend a tax break on foreign profits.

The nation came together after September 11 as it has for decades. It put aside its differences to stand on common ground to face a common enemy. Washington can do no better. Exploiting national security for private gain is not in the national interest.

RUSSIA'S PIPELINE TO RICHES

The unexpected willingness of Russia to join the U.S.-led coalition against terror signaled its return to the international strategic stage. But from an economic perspective, the sight of Russia dueling with Saudi Arabia over oil prices is perhaps equally significant. It's a sign that Russia, the No. 2 producer, is finally beginning to take a higher profile in the world economy. That's something Western countries should welcome and encourage.

For one, oil is giving Russia its first real stake in the health of the global economy. All other things being equal, oil prices rise and fall with world growth, so that Russia benefits when the global economy does well. That's something to which Russian President Vladimir V. Putin is paying attention. In a Nov. 20 speech to Russian energy executives, he said that Russia should develop its oil and gas industries to stimulate world economic recovery.

Moreover, Russia's oil industry is mostly in private hands. While Putin has enormous power, he can't simply order companies to raise or lower production—and that sort of decentralization is a healthy harbinger for the Russian economy. By contrast, in Saudi Arabia and most other OPEC countries, oil production quotas are set at the government level.

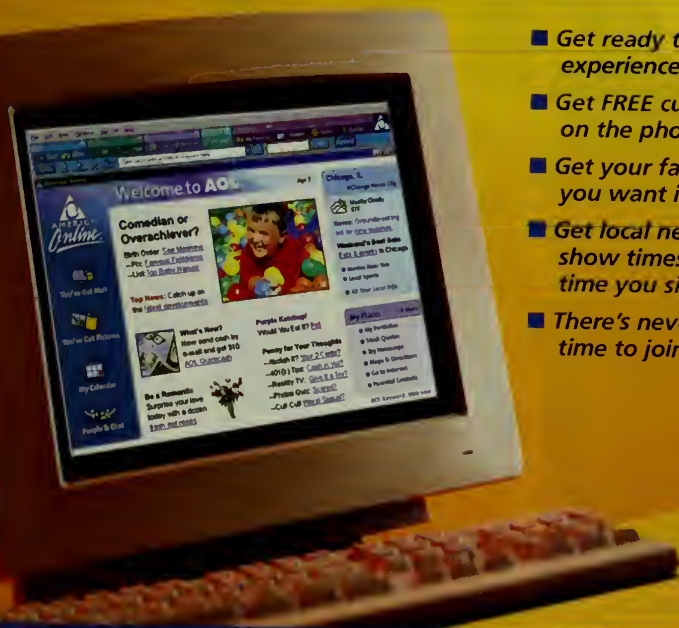
Still, there are two clear and present dangers to the economic resurgence of Russia. The first danger is that Putin

could be tempted to exert control from above. He recently put his own person in charge at Gazprom, which is owned by the government. The intention was good—to reduce corruption and provide access to Gazprom's monopoly pipeline system to all gas producers. Putin is doing the same thing in the defense industry, pushing for consolidation among many small and unprofitable private firms to create a viable set of competitors. But as attractive as this sounds in the short term, such top-down management runs the risk of backsliding into a command-and-control economy.

The other problem is that excess reliance on oil revenue could get Russia stuck in the same trap as Saudi Arabia. Historically even the most successful commodity-based economies have had a tough time industrializing. In Russia today, energy sales contribute 16% of gross domestic product and generate one-third of federal budget revenues. That could potentially lead to over-dependence on oil and gas production as an economic engine. Western economies can help avoid this by putting investment dollars into other industries in Russia besides energy.

But unlike Saudi Arabia, Russia has an enormous wealth of human capital in the form of educated, technologically skilled workers, which should pay off in the long run. In the end, an economically vibrant Russia is in the West's best interest.

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IS IT REAL?



MYTH: Bigfoot in the woods.



FACT: Linux in the enterprise.



BusinessWeek

DECEMBER 10, 2001

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DRUG PRICES WHAT'S FAIR?

How do we encourage research
and keep remedies affordable—
for anthrax, AIDS, cancer,
and beyond?

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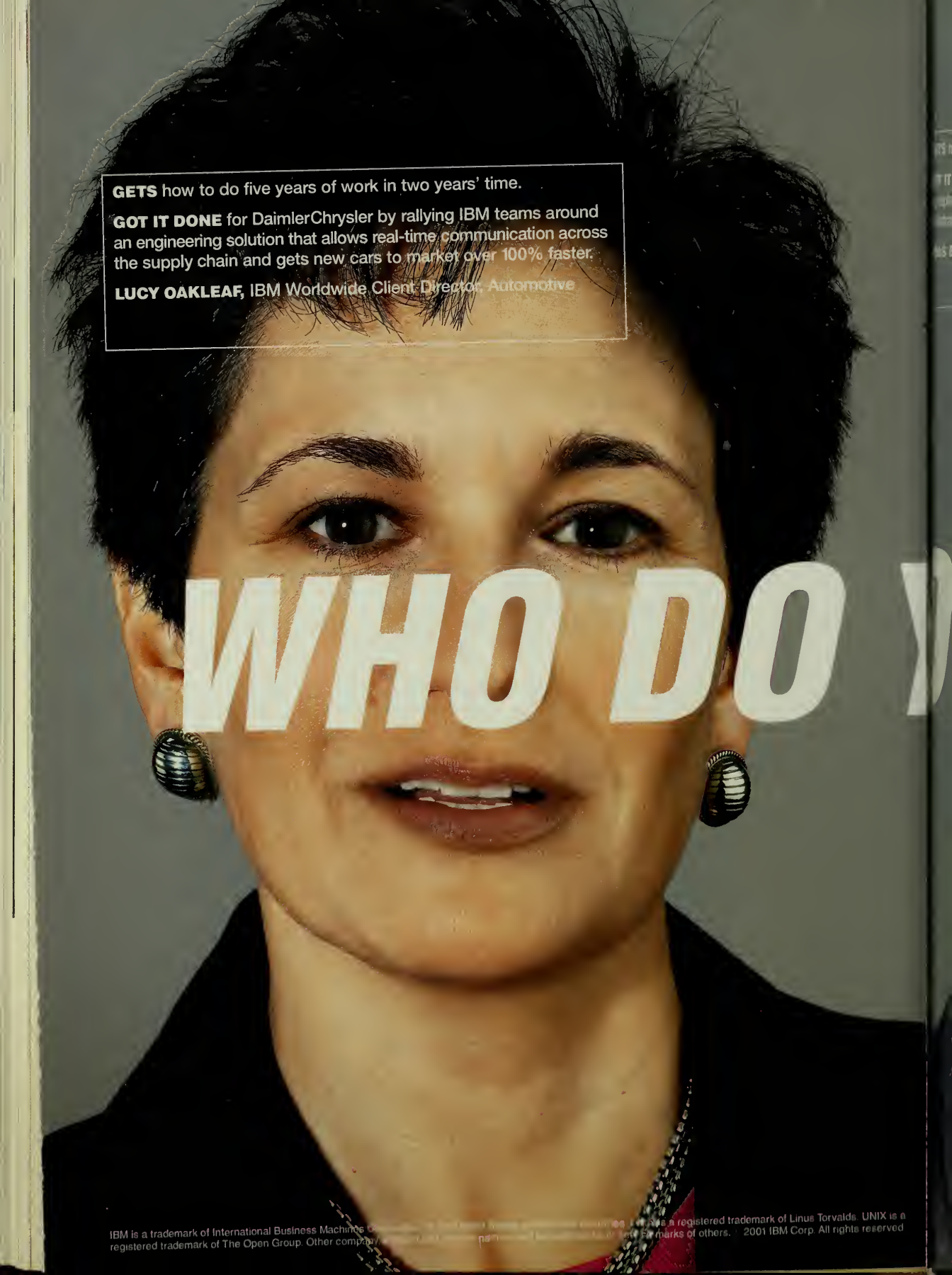
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A close-up portrait of Lucy Oakleaf, a woman with short dark hair, looking directly at the camera. She is wearing large, dark, textured earrings and a dark jacket. The background is a plain, light color.

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Love the
typeface

A high-contrast, black and white photograph of a man looking down, with a yellow sticky note in the foreground. The sticky note has handwritten text in red and black ink. The red text reads "to" and "nger." The black text reads "Reduce by 15%". The background is dark and textured, possibly a wall or a piece of fabric. The overall mood is somber and contemplative.

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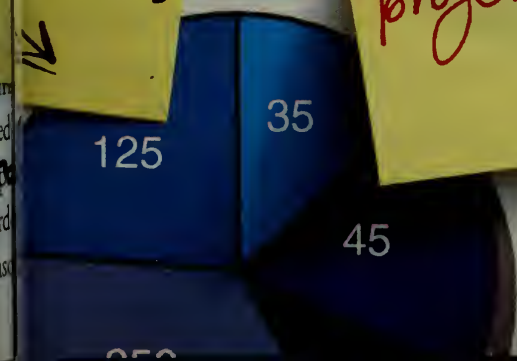
Other Assets

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I DIDN'T JUST HELP CHANGE THIS BUSIN

CRM SOLUTIONS

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DRUG PRICES: WHAT'S FAIR?

To curb runaway costs, America needs to stop overprescribing, give generics a fairer shake, get better information on which drugs work best, and make patients shoulder a bigger slice of the cost page 60



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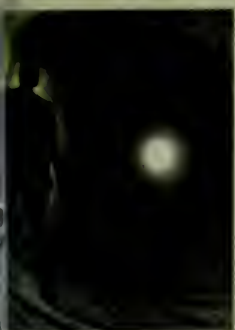
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■ IN THE BEAR CAMP:

The costs of war and homeland security could delay a true economic recovery, says BW's Margaret Popper



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Merry Malls?

A trip to a Minnesota shopping palace gives reason to hope that the current economic slump may not live up to the pessimists' worst expectations



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Up Front

EDITED BY SHERIDAN PRATT

PENSION PITFALL

POLAROID BRASS SAYS: ME FIRST

HOW SAFE ARE COMPANY pensions? With layoffs and corporate bankruptcies mounting, consider the roller-coaster case of Polaroid.

In the week before Polaroid declared bankruptcy on Oct. 3, more than a dozen senior execs—including a handful of company officers—quit. Their fear, company insiders say, was that the government would end up taking over Polaroid's pension plan and cap annual pensions at \$40,700. By leaving early, the execs took away their pensions in lump sums, totaling millions of dollars. That compounded another problem, that many of the 3,365 employees who had been laid off prior to bankruptcy had also opted to take their pensions in lump sums. The result: Polaroid's pension plan was underfunded by \$100 million, or 10%, as of Oct. 1. The government Pension Benefit Guaranty Corp. stood ready to step in.



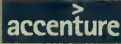
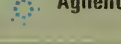
At the same time, Polaroid abruptly cut health-insurance subsidies for its 5,000 retirees. That left some retirees facing expensive medical bills without coverage. Many could soon pay as much as \$5,000 a year out of pocket.

Recently, however, the stock market rise has put Polaroid's pensions back in the black—at least for now. Polaroid won't comment on the pension fund except to say it's continuing to operate as normal. Polaroid is hoping a buyer will take over its assets, as well as its pensions. If that happens, the Pension Benefit Guaranty Corp. won't be needed. But if it doesn't, many loyal Polaroid employees who went down with the ship may end up poorer than the bosses who bailed out.

Geoffrey Smith

THE LIST WHAT'S WITH THE LETTER 'A'?

Consultants say "A" names are more popular than others when companies change identities. Why? They then can come first in alphabetical listings.

NEW NAME	OLD NAME	
 Altria	Philip Morris	Derived from the Latin <i>altus</i> , meaning "high"
 accenture	Andersen Consulting	Company says name puts "accent or emphasis on future"
 AVAYA	Lucent spin-off	Made-up name of no particular origin
 Aventis	Hoechst, Rhône-Poulenc merger	Was the name of a Hoechst research group
 Agilent	Hewlett-Packard spin-off	Made-up name derived from "agile"

Data: BusinessWeek

TALK SHOW "The only stopping place that I see is zero, and if going to zero is constructive, then we ought to do it."

—Federal Reserve Bank of St. Louis President William Poole discusses the possibility of lower interest rates

AFTER 9/11

A WAR THE DRUG SMUGGLERS HATE

EXPECT TO ADD DRUG smuggling to the casualty list in the war on terrorism.

The U.S. Customs Service reports that drug seizures for the just-ended fiscal year were 16% higher than last year and almost twice the amount seized four years ago. Heroin seizures were up 40% from last year, the biggest jump in any of the drug categories.

Stepped up efforts pre-September 11 are mostly the reason. Now, with even more strict security at

the nation's 301 entry points, seizures are likely to accelerate.

That's a good thing, since the ban on growing opium poppies in Afghanistan, one of the source of much of the world's heroin, isn't being

enforced as strictly as in previous years now that the Taliban is heading for the caves. The Taliban's stance on drugs may indeed have made a difference in the past. U.S. customs seizures of hashish, also a Central Asian staple whose cultivation was banned by the



POPPIES: More heroin, more busts

ban, fell to 777 pounds last year, down from 24,096 pounds in 1999. *Paul Maguire*

AIRPORT BLUES

SOOTHING THE SAVAGE TRAVELER

HOLIDAY TRAVELERS PASSING through Chicago's O'Hare International Airport in December will get the blues—literally. To make standing in long lines more palatable, the airport will bring in local bands to entertain passengers in the evenings of Dec. 6-24 while they wait to check luggage or wind their way through security. The tunes: pop, reggae, jazz, and, of course, Chicago blues.

The concerts are just one of the many ways airports across the country hope to inject a little Christmas spirit into flying. Air traffic picked up substantially over

Thanksgiving after a two-month hiatus. But the increase, combined with tightened security screening, meant for big crowds, long waits, and cranky passengers. So airports from San Jose to

Dallas/Fort Worth to Fort Lauderdale sent in clowns—and jugglers, magicians, and face painters.

Baltimore/Washington International Airport, which amused Thanksgiving travelers with Madonna and Axl Powers impersonators and jugglers dressed as turkeys and pilgrims, plans a secret revue from Dec. 5-24, to time with a high school song-and-dance group, a Girl Scouts



YEAH, BABY: Impersonator at B

chorus, cheerleaders, and, of course, Santa Claus.

Says a RWI exec: "We're trying to relax our passengers during this hectic time. Well, if you call that relaxation." *Michael A.*

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Up Front



UNDERGROUND: Soon to be phone-friendly

plans to install cell-phone transmitters underground, but September 11 compelled them to make haste.

San Francisco's BART (Bay Area Rapid Transit) found in a survey

that riders who previously protested cell phones underground now want them—by a margin of 2 to 1. BART will take the recommendation to its board for approval in December. "After the events of September 11, the argument that it was a matter of safety, not of business, gained a lot of ground with people," says a BART spokesman. Andrew Corp., which won a preliminary agreement to build BART's network, is installing similar systems for Chicago's El trains and Boston's T, at a cost of about \$15 million each. "Their ridership is pressuring them to speed up the process," says Andrew's Group President for Wireless Products Charles Jacobs.

Metropolitan Atlanta Rapid Transit Authority (MARTA) will ask its board to take wireless bids later this month. And Los Angeles, after neglecting cellular access when it built the final leg of its subway last year, will call for bids in 2002.

Yet, the city that may feel the need for access most acutely may never get it. The New York City Metropolitan Transit Authority said in early 2001 that it was in discussions to install a cell-phone network. But with damage to the subway from the World Trade Center collapse expected to cost \$1.7 billion, repairs will have to come first. "Cell phones did not become a priority after September 11," says an MTA spokesman.

For the rest of the country, construction is expected to take 12 to 18 months. Until then, relish the ringless commute. *Julia Cosgrove*

AFTER 9/11

THE SUBWAY IS GONNA GET NOISIER

WITH ALL THE SCARES THESE days, people want to be in constant communication—even on the subway. In Boston, Chicago, and San Francisco, transit officials have long had

AS THE DOWNTURN TURNS

ECONOMIC GLOOM HAS ITS advantages—if you're a recruiter at the Church of Scientology. A red-and-white "Now Hiring" sign sits outside its Washington (D.C.) headquarters, with a poster of prominent members John Travolta and wife Kelly Preston. Personnel director Trudy Lamb won't say how many jobs are on offer or what they pay, only that there are "more jobs than you can imagine," including accountants and receptionists. Since the signs went up in late September, 15 people have applied and four have signed five-year contracts.

Converting "is not absolutely mandatory," says Church President Susan Taylor. "But we do ask that they take courses. This is a church, after all." And, in these hard times, it's a job. *Brian Grow*

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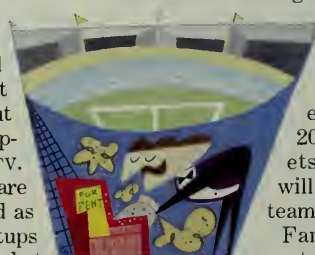
IT REALLY WILL BE A SOLD-OUT GAME NOW

FINALLY, A MARKET SOLUTION to an old problem. Because of no-show season ticket holders, 300-odd seats to see the sold-out Colorado Avalanche sat empty each game. Frustrated fans couldn't get tickets but saw all the empty seats on TV.

Such seats are now being filled as a slew of startups build online ticket exchanges. They let season ticket holders sell tickets they otherwise wouldn't use. "If you're a sponsor or an advertiser, you want to see those seats full," says David Carter

of L.A.-based consultancies Sports Business Group.

Season Ticket Solutions runs the Avalanche's new change. LiquidSeats has deals with teams including the Arizona Diamondbacks and Seattle SuperSonics. Smart recently finished a pilot with the San Diego Padres.

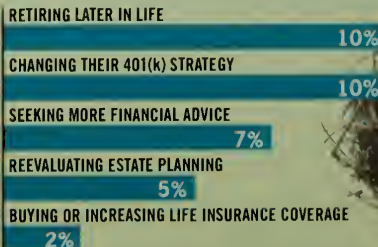


San Francisco Giants began one of the earliest exchanges, in 2000, with TicketCity.com, which will add other teams next season. Fans should expect bargains: Most teams set minimum ticket prices. And service charges, split by the team and vendor, can add 20%. But beats watching empty seats on TV. *Kimberly We*

THE BIG PICTURE

RETHINKING RETIREMENT

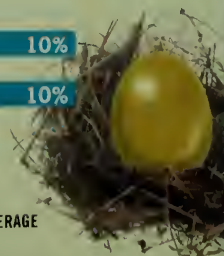
About 25% of Americans say September 11 has caused them to change their retirement plans* by:



ONLINE POLL OF 628 ADULTS WITH INCOMES OF AT LEAST \$75,000, OCT. 10-12

*RESPONDENTS WERE ALLOWED MORE THAN ONE ANSWER

Data: Northwestern Mutual Financial Network/Harris Interactive



Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com



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WHAT MANKIND NEEDS: LESS WHINING FROM SCOTT MCNEALY

Sun Microsystems CEO Scott G. McNealy thinks mankind needs a break from Microsoft Corp. ("Face-off," Cover Story, Nov. 19). What mankind really needs is a break from McNealy's incessant whining. Many people and business complain about Microsoft's monopoly. None has bothered to offer a superior product. Instead, they have used the government as a strategic weapon to cover their inability to develop something better. Microsoft may have a monopoly with Windows and Office, but it hasn't come close to the same level of domination on the Web. If it had, America Online Inc. wouldn't still be around.



Technology writers from many publications have pointed out many flaws, weak areas, poor designs, and glitches in Microsoft products. What does it say about the rest of the software industry that Microsoft was able to achieve a monopoly with such imperfect products? Innovation won't happen just because the government suppresses Microsoft.

William A. Kirsten
 Gaylord, Mich.

We have been reading Scott McNealy's "trash talk" for years. I would

suggest he start concentrating on his own company's failings.

W. Donald S.
 Lake Forest,

If McNealy could just hold on for a few years, perhaps he could find another Administration like that of Bill Clinton. He could again donate heavily to the Democratic Party and again get them to shackle his competition.

Come on McNealy: Suck it up, and compete like a big boy!

Joe R. Donath
 Centennial, CO

Scott McNealy's outlandish attitude on Bill Gates and Microsoft, and his sophomoric humor, make one wonder why Sun Microsystems stockholders put up with this overgrown child.

Norman Col
 Potomac, MD

WRITE THE RIGHT LAWS TO REIN IN SOFTWARE MAKERS

Animals that prey on others are usually successful only against the old and the lame. That is all that Microsoft has done ("Settlement sellout?" Cover Story, Nov. 19). WordPerfect failed to innovate, Word won. Lotus failed to innovate, Excel won. Netscape never stood a chance as a stand-alone, so Internet Explorer won. Microsoft had nothing with which to compete when it took these entities on, so it beat them fair and square.

Microsoft has not beaten RealAudio, Adobe Systems, Intuit, Norton, and many others, because those companies innovated and improved their products. We the consumers and users have stood to gain by letting the better innovator vanquish the lesser. Microsoft should use everything in its arsenal

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CORRECTIONS & CLARIFICATIONS

"A boffo season for video games?" (Up Front, Nov. 19) incorrectly identified the publisher of the games NHL 2002 and Madden 2002 as Sony. Those games are published by Electronic Arts Inc.

In "Up a creek—with lots of cash" (News: Analysis & Commentary, Nov. 12), *BusinessWeek* incorrectly said that R.R. Donnelley & Sons Co. was the world's largest commercial printer. That distinction belongs to Quebecor World Inc. of Montreal, with \$6.5 billion in 2000 revenues. Donnelley is No. 2, with \$5.8 billion.

compete. That is inherent in our economic system.

Richard S. Mitnick
Highland Park, N.J.

If lawmakers had made software developers accountable for the operation of their wares, the Microsoft debacle could have been avoided. Microsoft would have had to recall products that crashed. It would have been less tempted to develop "bloatware" and bundle others' products into its own, lest it cause crashes. Taxpayers would have saved a lot of money.

Tony Payne
Hong Kong

"Slapping Microsoft's wrist" (Editorials, Nov. 19) relies heavily on Scott McNealy's constant mischaracterizations of the Microsoft settlement. The piece recites the vague and sometimes blatantly inaccurate complaints about the settlement that are often cited by Microsoft's largest rivals.

Coming after three years of litigation, the settlement between the Justice Dept. and Microsoft should finally allow the software industry to get back to work full-time. We in the industry hope that McNealy got the message.

Jonathan Zuck
Association for
Competitive Technology
Washington

What if that softie [antitrust chief] Charles James limited what *BusinessWeek* could charge at the newsstand?

Patrick M. Code
Alpena, Mich.

THERE'S NOTHING WRONG WITH ACCOUNTING PRINCIPLES

The Financial Accounting Standards Board unequivocally agrees with your

statement, "Without integrity in financial reporting, the U.S. cannot hope to remain the preeminent place to invest in the global marketplace" ("End the numbers game," Editorials, Nov. 26). Unfortunately, much of the remaining editorial reflects a misunderstanding of FASB. FASB is a standard-setting body whose mission is to promote high-quality reporting, aimed at producing integrity in financial statements. FASB has no control, nor can it exercise any authority, over a company's statements about its earnings—including so-called pro forma earnings. That is the province of audit committees, auditors, and the Securities & Exchange Commission.

In FASB's view, generally accepted accounting principles (GAAP) numbers provide the most reliable picture of a company's true earnings. Despite the issues *BusinessWeek* raises about the usefulness of GAAP numbers, it is interesting to note that Enron Corp. is now restating its numbers to conform with GAAP. Given the concerns voiced about inflated earnings, it is ironic that the GAAP earnings-per-share number referenced in relation to Thomson Financial/First Call and the Standard & Poor's 500-stock index is by far the least inflated.

FASB recently added a new project on financial-performance reporting to its agenda. The objective is to improve the quality of information displayed in financial statements, to help investors and creditors evaluate a company's performance based on GAAP. Because the FASB does not have authority over how a company describes itself in press releases, analyst presentations, and similar media, this new project will not address pro forma earnings.

Edmund L. Jenkins
Chairman
Financial Accounting
Standards Board
Norwalk, Conn.

WILL MERRILL LYNCH STILL WELCOME SMALL ACCOUNTS?

"Shaking up Merrill" was most disturbing to me, a longtime "small account client" at Merrill Lynch & Co. (Management, Nov. 12). For many years, I have had a comfortable, friendly, trustful relationship with my brokers there—what you called the Merrill culture. Experiencing this over a number of years made it easy to select Merrill as the corporate trustee for my estate.

However, the new drive in Merrill's personal services to "focus squarely on courting the rich" makes me feel I am

being dealt out of doing business what was a welcoming, receptive environment. Any advice on where I can find the old "Merrill culture" elsewhere?

A.F. Kaula
Rye, N.Y.

ONE VOCAL TIAA-CREF INVESTOR IS NO PROXY FOR ALL

I fail to see how Neil Wollman's assertion that he decided not to make the proxy deadline acts as a case "against" TIAA-CREF's current practice ("Let shareholders decide this on BusinessWeek Investor, Nov. 19). Wollman may not agree with the proxy vote system, but this doesn't lend him any more credibility than anyone who actually participates in it. Why should (or TIAA-CREF CEO John Biggs) allow him to take us all down by bending the rules?

David Charles P.
Pittsburgh

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THE BEST BUSINESS BOOKS OF 2001

How do run-of-the-mill businesses become front-runners? That's the question posed in Jim Collins' *Good to Great: Why Some Companies Make the Leap...and Others Don't* (WarperBusiness). The volume is one of 10 top business books of 2001 as judged by *BusinessWeek* reviewers.

Collins is co-author of the perennial best-seller *Built to Last*. In this new book, he crunches decades of data to divine what separates 11 overachievers from a control group of peers that didn't make the leap from average to top performers on Wall Street. From Abbott Laboratories to Wells Fargo & Co., all of Collins' great companies were commanded by low-key CEOs whose ambition was "first and foremost for the company." They surrounded themselves with smart, hard-working people who were not afraid to face their shortcomings. These managers never lost sight of what their companies did best. Over time, thanks to their perseverance and the careful use of technology, the enterprises lifted off. Although reviewer Michael Ondaatje felt the author relied too heavily on share price as the chief measure of greatness, he judged that Collins again has written a book that seems built to last.

Although it isn't on Collins' list, General Electric Co. is, to many, the epitome of greatness. And in a way you haven't heard, its former CEO, Jack Welch, happens to have a book of his own. *Jack: Straight From the Gut* (Warner), written with *BusinessWeek* Senior Writer John A. Byrne, is a highly subjective and uneven first-hand account, delivered

in the sometimes electric, sometimes brutal voice of an archetypal captain of industry. There are riveting stories—including how Welch worked his way into the CEO's office, how he wisely bought NBC and foolishly bought Kidder, Peabody & Co., and how the attempted acquisition of Honeywell International Inc. was thwarted by European regulators. There's an impassioned defense against charges that GE polluted the Hudson River with PCBs. But the topic dearest to Welch's heart is personnel: getting, grooming, and keeping the best, while dumping those judged second-rate. "This is a valuable, pungently written business book by a man who lights up every room he enters," said reviewer Ken Auletta.

Another corner-office autobiography is *Swimming Across: A Memoir* by Intel Chairman Andrew S. Grove (Warner). But this account focuses strictly on formative years—Grove's childhood in Nazi-occupied and later Communist-led Hungary. Perhaps it was here that Grove developed a penchant for risk-taking and an ability to persevere against the odds. In 1944, the German army marched into Hungary. Young Andris Istvan Grof's father was conscripted as a laborer, and the boy and his mother soon fled Budapest for the countryside. When Russians replaced

Germans after the war, the torment didn't cease. A soldier raped Grove's mother. His father miraculously returned, emaciated beyond recognition, only to see his dairy business nationalized. Finally, with the Russian suppression of the Hungarian uprising in 1956, Grove set out with a young friend on a perilous run, mostly at night, for the Austrian border. Capped by a dramatic escape to America, the account is "fascinating and moving," said reviewer G. David Wallace.

This year's list includes two books treating the Justice Dept.'s antitrust lawsuit against Microsoft Corp. The volumes may be seen as complementary, since they cover different ground. *Wired* correspondent John Heile-



Our Top Ten*

COLOSSUS

by Jack Beatty

EMPIRE

by Mitchell Pacelle

GIANTS OF ENTERPRISE

by Richard S. Tedlow

GOOD TO GREAT

by Jim Collins

JACK

by Jack Welch with John A. Byrne

NEXT

by Michael Lewis

NICKEL AND DIMED

by Barbara Ehrenreich

PRIDE BEFORE THE FALL

by John Heilemann

SWIMMING ACROSS

by Andrew S. Grove

WORLD WAR 3.0

by Ken Auletta

* In alphabetical order

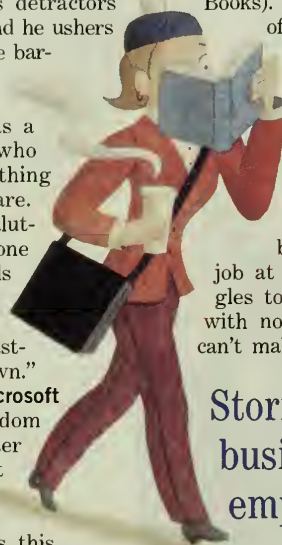
mann's **Pride Before the Fall: The Trials of Bill Gates and the End of the Microsoft Era** (HarperCollins) is less about the trial per se than about the background to the litigation. Heilemann describes how the anti-Microsoft movement began with the complaints of a few disgruntled Silicon Valley executives. He details the troubles Justice had in getting Microsoft's detractors to testify on the record. And he ushers the reader into many of the bargaining sessions between Justice's lawyers and Microsoft's. Gates appears as a kind of child emperor who thinks he knows everything about both law and software. Reviewer Dan Carney saluted the author for taking one of the most complex trials in history and turning it into a book that reads "almost like a thriller—fast-paced and hard to put down."

In **World War 3.0: Microsoft and Its Enemies** (Random House), *New Yorker* writer Ken Auletta seeks to put the reader inside Judge Thomas Penfield Jackson's courtroom. At times this can be slow going, as the author follows the trial witness by witness. But "where Auletta excels is in getting Jackson to open up," found reviewer Carney. The judge tells the author that he finds Chairman Bill Gates "Napoleonic" and "arrogant," and Jackson describes Microsoft's behavior as "sophomoric." Then, Jackson turns his fire on appeals courts, which he says embellish their rulings with superficial scholarship. Once again, Gates comes in for harsh treatment. "Crowds do not part when he enters a room," says Auletta of Gates, whom he describes as sitting "slumped when on a stage, looking less like a mogul than a boy ordered to wear a suit."

A lively account of Digital Age doings may be found in **Next: The Future Just Happened** (Norton) by Michael Lewis, author of *The New New Thing* and *Liar's Poker*. The author views the Internet as a potent new weapon for amateurs of all stripes, especially the young, to wield against what he sees as the crumbling hegemony of professionals such as lawyers, stock analysts, and media executives. Among the newly empowered is a 14-year-old New Jersey kid whom the Securities & Exchange Commission accused of profiting by fraudulently manipulating stocks under aliases on online message boards. Reviewer Robert D. Hof termed the

entertaining book "a wake-up call at a time when many believe the Net was a flash in the pan," offering "the first, unsettling glimpses of capitalism's ruthless new future."

A different kind of social commentary may be found in Barbara Ehrenreich's **Nickel and Dime: On (Not) Getting By in America** (Metropolitan Books). The social critic and author of *Fear of Falling* tells what she found when she left a comfortable life to join the workforce of \$6-to-\$7-an-hour housekeepers, salesclerks, restaurant workers, and the like. A key finding: The working poor have little choice but to take more than one job at a time. Ehrenreich struggles to keep costs low, but even with no children to support, she can't make ends meet on one pay-



Stories of the people behind business: Moguls and maids, empire-builders, egotists, and e-scramming kids

check. Working two jobs—as a maid and as a nursing-home aide—proves exhausting. And getting cheap, safe housing proves an ongoing challenge. The volume is by turns painful, angry, and amusing, as the author often finds humor in her own plight. Said reviewer Anne Colamosca: "This important volume will force anyone who reads it to acknowledge the often desperate plight of Ehrenreich's subjects."

There's more social criticism, and humor, to be found in **Empire: A Tale of Obsession, Betrayal, and the Battle for an American Icon** by *Wall Street Journal* writer Mitchell Pacelle (Wiley). This tale of the Empire State Building focuses on New York's sometimes seamy real estate scene and brings alive a vivid cast of characters. There's Leona Helmsley, the "Queen of Mean"; Donald J. Trump, who considers remaking the upper floors of the Empire State into luxury condos; and Hideki Yokoi, a Japanese businessman with a penchant for trophy properties. Pacelle gives the reader an overview of New York real estate, one of the city's greatest generators of wealth. And his tale of the battle for the Empire State features legal wrangling, political posturing, family feuds, financial high jinks, and lost for-

tunes. No wonder reviewer Robert M. Natt called the book "a finely wrought narrative that embodies the style—a hysteria—of New York real estate."

A historical look at business may be found in *Atlantic Monthly* Senior Editor Jack Beatty's **Colossus: How the Corporation Changed America** (Broadway Books). Scholars often debate the relative importance of various institutions—churches, say, or political parties—in shaping developments. Beatty feels there's one institution whose clout has consistently been underestimated: the corporation. *Colossus* is composed of readings ranging from historian Alfred D. Chandler Jr.'s description of the emergence of modern administrative business hierarchies to novelist Joseph Heller's account of throat office culture. The author provides essays pondering the place of the corporation in the good society—worrying that there is no adequate counterweight to global corporate power. Reviewer Christopher Farrell, a contributing economics editor, found that "the historical essays that make *Colossus* form a better business book than many management tracts."

Finally, there's **Giants of Enterprise: Seven Business Innovators and the Empire They Built** by Harvard Business School historian Richard S. Tedlow (HarperBusiness). This gallery of executive portraits describes the careers and personalities of steelmaker Andrew Carnegie, auto maker Henry Ford, Sam Walton of Wal-Mart, George Eastman of Eastman Kodak, Thomas J. Watson Sr. of IBM, Charles Revson of Revlon, and Robert Noyce of Intel. The author explores the common traits that help these men realize success, such as ability to create or adopt new technology faster and more effectively than others. He also describes their peculiarities—and the tendency of many of the men to lose their grip on reality, veering into what the author terms "derangement." Carnegie, for instance, felt that he alone could achieve world peace. Ford became a crusading anti-Semite. A review that will appear in a coming issue, Christopher Farrell says that even though the lives of these entrepreneurs are well-known, Tedlow's "passionate and fluid writing" makes *Giants of Enterprise* a pleasure to read.

COMPILED BY HARDY GREEN
Green is Books Editor

BY STEPHEN H. WILDSTROM

shand@businessweek.com

BRINGING THE STACKS TO THE STUDENTS



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Since my long-ago days as an undergraduate, computers have changed many things about campus life. Students receive assignments and turn in their work over the Web. They chat with one another and with instructors in on-line class discussion groups. The "textbook" is likely to be a collection of chapters from various sources, chosen by the professor and custom-printed at the school bookstore or at a local Kinko's. But one thing has remained largely the same: Researching a paper still requires lots of hours in the library. The catalog is in a computer, not on cards, and notes may be taken on a laptop, but the process has hardly changed for generations.

Libraries are essential because only a tiny fraction of the knowledge contained in books is available on the Web—and what's there is hard to find or use. Things should change as more and more books are put into electronic form and as publishers and distributors figure out how to make money in the process.

Questia Media America (www.questia.com), a Houston startup, is at the forefront of creating an online library geared to college students. For a subscription fee of \$19.95 a month, students gain access to nearly 70,000 books in the social sciences and humanities. They can search text, take notes within Questia's Java-based application, and store them as part of a "project" on a Web server. Students can copy text from an on-line book, and when they paste it into a word processor, it generates a citation or footnote in one of several standard styles, such as American Psychological Assn. or Modern Language Assn. At the end of the project, all of the references can be gathered together and pasted into a document as a bibliography. While it seems extravagant for Questia to claim that a student can save 7 to 10 hours of work on a 10-page paper, I can see how it would be a big help.

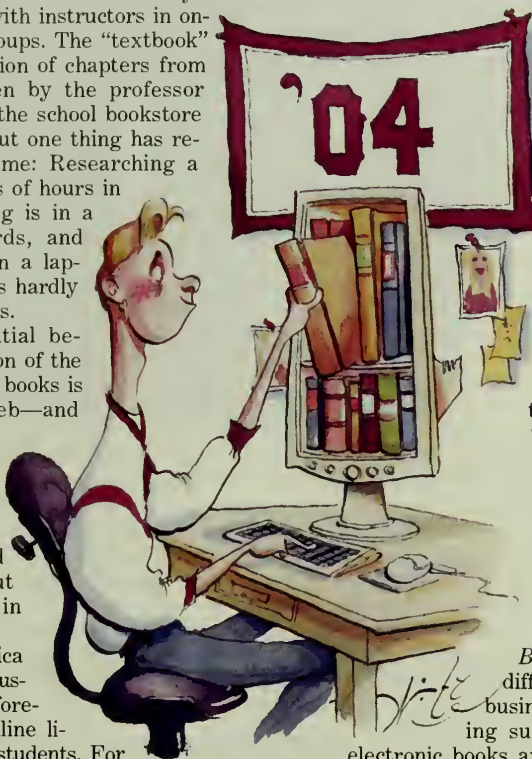
But there are some problems. First, for all practical purposes, Questia users can only read books or journal articles on-screen. They can

print the text, but only one page at a time, and the printout looks like a Web page, not a page from a book. (Publishers will not allow unlimited printing.) Most students who want to read sections of books, not just extract quotes, are going to want a hard copy of the actual book or journal.

A second weakness is the scope of the on-line library. While 70,000 items sounds like a lot, it is barely half of the new works acquired each year by the libraries of my old stomping grounds, the University of Michigan. Questia does not include the physical sciences or mathematics, and even where it specializes, coverage can be spotty. For example, a search in sociology for "Emile Durkheim" turned up *The Division of Labor in Society*, though Durkheim was listed as the translator rather than as author. Questia is missing his classic *Suicide*, a work found in any middling undergraduate library. "Students in the first or second year writing on a subject we support well could use Questia exclusively," says Questia CEO Troy Williams. "Upper-division and graduate students will need physical resources as well."

Ebrary, a Mountain View (Calif.) startup (partly owned by The McGraw-Hill Companies, parent of *BusinessWeek*) takes a different approach to the business. Rather than selling subscriptions, it makes electronic books available on a pay-per-use basis. You deposit money in an ebrary account, then pay a quarter to copy a quotation or 25¢ per page to print as much of the work as you want. One big advantage over Questia: Ebrary text is presented in Adobe Acrobat, so printing gives you a reasonable facsimile of the original. You can see a demonstration of ebrary at learningnetwork.ebrary.com, but with only 1,500 titles online, it's hard to tell how useful the service will ultimately be when many thousands of titles are available.

Even in their primitive state, it's easy to see how online libraries could take a lot of the tedium out of research. I don't think they will ever replace the pleasures of browsing the stacks of a serious research collection. As a lover of old-fashioned libraries, I certainly hope not. But as a tool to simplify the chore of much student research, the online library's day is coming.



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BY ROBERT J. BARRO

IS PROSPERITY NEXT TO GODLINESS?



BELIEFS:
New research weakens the theory that the role of religion declines as societies become wealthier and better educated

From an academic standpoint, an important effect of the September 11 attacks was the large increase in the demand for college classes related to religion and for research on religious behavior. Coincidentally, I have been involved in a new project on religion, economy, and society, directed by Dr. Rachel M. McCleary at Harvard's Weatherhead Center for International Affairs (see the Web site: www.wcfia.harvard.edu/religion). This project has already generated some surprising findings about the relation of religion to economic and social variables. Here are a number of them.

One area of research covers the ways that church attendance and beliefs in God, an afterlife, heaven, and so on evolve as economies develop. An old idea (called the secularization hypothesis) is that attendance and beliefs decline as societies become wealthier and better educated, perhaps because people become more influenced by science and, therefore, less inclined to accept the supernatural.

The data for 60 countries over the last 20 years do show a pattern of richer societies being less religious. However, the extent of religiousness turns out to rise with education. Professor Edward Glaeser of Harvard University observes that for the U.S., within denominations, more highly educated persons tend to attend church more frequently. Religious practice, on the other hand, does fall along with other indicators of economic development, notably urbanization and life expectancy. These patterns hardly seem consistent with religion being nonscientific or nonmodern.

The research also reveals how the existence of a state religion, contrary to my expectations, has a positive effect on attendance and some religious beliefs. When, however, governments regulate religious organizations, church attendance declines, though there is no effect on people's beliefs. Church attendance seems to be stimulated by the availability of a broad array of religious choices, as in the U.S. Not surprisingly, Communist oppression dramatically reduced religious behavior. However, the experience of Eastern Europe shows that people return to church once they are liberated from Communism.

Among the major world faiths, Roman Catholicism and Islam rank highest in promoting church attendance and beliefs. Muslim nations rank particularly high in beliefs in heaven and hell. Predominantly Muslim countries also stand out by having high fertility rates and low propensities for

democracy. However, these countries tend to have more equality of income and lower crime rates and do no worse than average on maintenance of the rule of law, levels of official corruption, and the extent of international trade. Because of the mixing of positive and negative factors in economic performance, the Muslim countries as a group experience roughly average rates of economic growth.

RELATIONSHIP RESEARCH. Future research plans to emphasize the topic that excited the German social scientist Max Weber in his famous book *The Protestant Ethic and the Spirit of Capitalism*: How do religion promote or deter economic development? Among the main religions, there is little relationship with economic performance—economic growth is about the same whether a nation is primarily Catholic, Protestant, Muslim, Hindu, or Buddhist. However, there is some indication that the extent of religious belief, though not the amount of church attendance, bears a positive relationship to economic growth. The ongoing research will hopefully shed more light on this type of relationship.

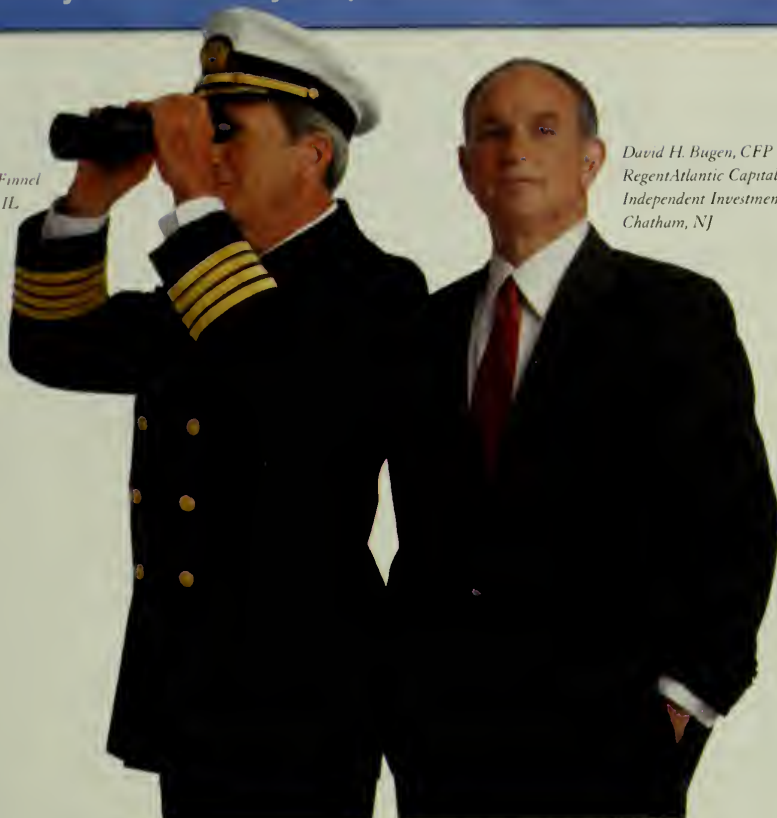
Professor Laurence Iannaccone of Santa Clara University has probably done the most important research over the last 15 years on the interplay between religion and economics. In the Weatherhead project, part of Iannaccone's research involves the connection between religious extremism and violence. He first analyzes the ways in which cults, fundamentalists, and other "religious extremists" maintain high levels of commitment among members. The mechanisms include indoctrination, rewards and sanctions in this life and the next, and forms of sacrifice and stigma.

Usually, extreme religious groups do not have to outsiders, but sometimes this extremism supports acts of great violence, like those of September 11. Such violence, including the worst forms of suicidal terror, rests upon commitment mechanisms that, in other contexts, encourage acts of compassion, kindness, and self-sacrifice. The policy challenge is to deter the former while not discouraging the latter. Iannaccone's argument is that violent manifestations of religious commitment often stem from governmental suppression of economic freedom, political dissent, and religious expression. In particular, it is a great mistake for governments to try to support "good" religion while repressing "bad" religion. A better policy is to promote liberty in the religious sphere as well as in the economic and political arenas.

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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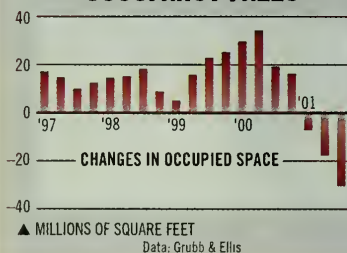
EDITED BY PETER COY

OFFICE SPACE: A NASTY HANGOVER

After a binge, companies cut back

In an ordinary commercial real estate slump, vacancy rates rise because construction of new space outpaces the market's ability to absorb it. Even in tough times, the amount of occupied office space usually rises at least a little each year. But this is no ordinary slump. Office space is actually emptying out.

U.S. OFFICE SPACE OCCUPANCY FALLS



So far this year companies have retreated from 40 million square feet of office space, which they are trying to sublet, according to real estate broker Grubb & Ellis Co. in Northbrook, Ill. Also, 15 million sq. ft. less office space is occupied because of damage to the World Trade Center area. A nationwide decrease in occupied space "didn't even happen in the last recession," says Robert Bach, Grubb & Ellis national director of market analysis.

The oversupply problem started in 2000, when companies rented more space than they needed. In an average year, rented office space should expand at the same rate as employment, according to Ross J. Moore, national director of research at Boston-based broker Colliers International. In 2000, job growth was just under 2.5%, but companies occupied an additional 140 million sq. ft. of space by Colliers' reckoning—a 6% increase.

Now, companies are shedding extra space with a vengeance. They have not only vacated all the extra space they rented in 2000 but will probably cut back an additional 30 million sq. ft. in the next two quarters, predicts Moore. Bach estimates that the vacancy rate could rise from its current 13% to as much as 18% a year from now. That's what it reached in the recession of the early 1990s.

There is a bright side to the aggressive cutting. "These companies are much leaner now and don't have any extra [real estate] inventory," says Moore. As they resume hiring, they'll be forced to occupy space they're currently trying to sublet, and vacancy rates could drop rapidly. So the market is likely to get back to normal in much less time than the six years it took to recover from the last recession.

By Margaret Popper

EC AUSTERITY IS BACKFIRING

Euro zone rules are stifling recovery

The euro zone slump is causing tax receipts to plunge and budget deficits to surge. Economists predict that the 12 countries that share the euro will spend \$120 billion more than their income next year. That's 2% of gross domestic product—way beyond the 0.3% shortfall that governments forecast when they set out their medium-term fiscal objectives a year ago. Several countries—notably recession-bound Germany—will be lucky to keep their deficits below the 3% ceiling laid down in the 1997 Stability & Growth Pact. The pact required European Union members to balance their budgets over a four-year period—meaning a deficit in one year has to be balanced by a surplus in another. "Like other governments, we based our projections on the expectation of solid economic growth," says a Finance Ministry spokesman in Berlin.

Instead, Germany got a sudden and severe slowdown—just as its neighbors did. Economists now predict that the euro zone economy will grow just 0.6% next year, compared with the European Commission's original estimate of 3%. Thomas Mayer, chief economist at Goldman, Sachs & Co. in Frankfurt, calculates that each 1% shortfall in GDP growth boosts the cumulative euro zone budget deficit by around 0.5% of GDP.

Because of the Stability Pact, governments don't have much room to stimulate demand by cutting taxes or boosting state spending. In fact, they are obliged to pursue policies that exacerbate the business cycle, injecting more money into the economy when it is growing and less when it slows.

Things won't change for the better very soon. On Nov. 21, senior European Central Bank officials hinted that they would tolerate a loosening of the Sta-

bility Pact next year if the economic situation deteriorated much further. But that will be too late to ease the current downturn. Germany, France, and their European partners are finding that financial rigor may not be as beneficial as they had hoped.

By David Fairlaid

VENTURE CAPITAL'S TURNING POINT?

VC outlays may have bottomed out

A hallmark of the newly christened recession has been a plunge in venture-capital spending. VentureWire, a unit of New York tech publisher Technology Partners, says venture investments in private U.S. companies more than two-thirds over the past year.

The question now: Has VC funding really hit bottom? There are some signs that it has. VentureWire calculates an index of venture outlays based on the previous 90 days of announced deals. The index, which has been dropping since July, 2000, leveled off in November (although the dearth of deals over Thanksgiving caused it to drop again when calculated on Nov. 26 and 27).

The rebound in the stock market may account for the leveling off. With the Nasdaq Composite Index up about a third from its post-September 11 low, venture capitalists could be regaining confidence that there will be a market for tech-stock initial public offerings.

Still, the VC market is far from healthy. Halfway through the fourth quarter, seed money and first-round financing accounts for just 12% of all disbursements, down from 25% in the first quarter, according to VentureWire data.

In other words, venture capitalists are putting almost all their money into saving existing businesses, rather than starting new ones. "There are a lot of companies that aren't even being looked at [for funding]," says John S. Taylor, research vice-president of the National Venture Capital Assn. He predicts VC disbursements could fall from \$7.7 billion in the third quarter to \$6 billion in the fourth.

A BOTTOM FOR VENTURE FUNDING?



BY JAMES C. COOPER & KATHLEEN MADIGAN

GOOD NEWS: MILD RECESSION BAD NEWS: MILD RECOVERY

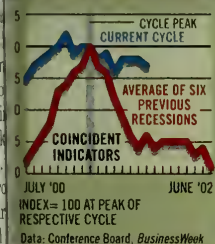
The downturn may soon be over, but don't expect demand to blast off

U.S. ECONOMY

Investors greeted the news that the U.S. is officially in recession with a shrug and a yawn. After all, the National Bureau of Economic Research's announcement at the downturn began in March was too backward-looking for most stock and bondholders. They are much more interested in where we go from here than where we have been.

Yet an analysis of the NBER's Nov. 26 declaration provides some insight into the shape of both the recession and the coming recovery. The first lesson is that, if history is any guide, the recession is almost over. Second, the downturn may well turn out to be the mildest since World War II (charts). And third, the unusual nature of the recession means that the recovery will develop only gradually.

THE RECESSION LOOKS MILD BY PAST EXPERIENCE



past experiences. That means the economy could start growing again, but the pace will be too slow to lower the jobless rate or improve investor sentiment.

These three ideas mean the outlook is a mixed bag. On the plus side, the economy won't experience the hit-a-brick-wall cessation of business activity that has been the norm in other recessions. Indeed, housing and autos, as well as many service industries, are still holding up. But when the upturn arrives, demand will not shoot out of the cannon as in

UNDERSTAND THE COMING RECOVERY, it's important to grasp the nature of the current downturn. It starts with the recession's length. The downturns since World War II have ranged between 6 and 18 months, with an average of 11. This one is now nine months old. The recession would have to be the longest in the postwar era for a recovery to be delayed past middle of 2002.

That's unlikely because the policy response during the slump has been far faster and larger than average. In fact, this is the first recession in which the Federal Reserve began cutting interest rates aggressively before the downturn even began. So far, the Fed's rate cuts have totaled 450 basis points, while cuts during the comparable period in the past 6 recessions have averaged only 180 points. Plus, the NBER's announcement

should help to break the deadlock in Congress over further significant fiscal stimulus. That's likely to total anywhere between \$65 billion and \$100 billion, and it will kick in early next year.

Perhaps more important than the downturn's length will be its depth, or the degree to which economic activity contracts and the jobless rate rises. The NBER's admission that before the September 11 terrorist attacks, "it is possible that the decline in the economy would have been too mild to qualify as a recession," strongly suggests that this episode could turn out to be the most shallow of all postwar downturns.

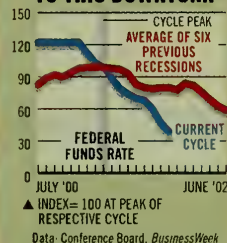
Contrary to popular belief, the NBER does not use gross domestic product to determine turning points in the business cycle. Instead, it looks at four monthly data series: industrial production; private-sector employment; sales by manufacturers, wholesalers, and retailers; and personal income minus various government transfers of income to individuals, such as unemployment benefits. Both sales and income are adjusted for inflation.

The Conference Board's index of coincident indicators is a composite of these four monthly measures. Since March, the coincident index has declined 0.3%. In the comparable time period of the past six recessions, the index fell by 1.6%. That means this recession is running far behind the average experience of the past six, and once the shock effects of September 11 have passed, the economy's prior resilience will very likely reassert itself.

THAT MAY ALREADY BE HAPPENING. Consumer spending bounced back strongly in October. Weekly sales reports from the Instinet Research Redbook show continued strength in November, and early reports of post-Thanksgiving shopping, while mixed as usual, are generally more encouraging than feared. Surprisingly, overall consumer spending is set to show a gain for the fourth quarter, which means that the forecasts of a 2%-or-greater decline in fourth-quarter GDP, made only a few weeks ago, already look far too bearish.

Moreover, measures of consumer confidence in November did not show any significant additional deterioration from the September and October drops. The

A RAPID FED RESPONSE TO THIS DOWNTURN



University of Michigan's measure rose slightly in November, while the Conference Board's gauge dipped to 82.5 from 85.3, amid job worries (chart). Still, even though households surveyed by the Conference Board noted that current conditions are worsening, they expressed increased faith that future conditions in the next six months would improve.

Plus, households seem willing and able to grab a good deal when they see one, including buying a home. October sales of existing homes recovered much of September's shock-related plunge, rising 5.5%, to an annual rate of 5.17 million. Since March, sales have averaged 5.27 million, far sturdier than in past recessions. Low mortgage rates and record refinancings are supporting both housing and consumer spending generally.

BUT THEREIN LIES A PROBLEM for the recovery. The NBER's four key indicators highlight an important atypical pattern of this recession. The bureau noted that "continuing fast growth in productivity and sharp declines in the prices of imports, especially oil, raised purchasing power while employment was falling." This rise in household buying power—even as the three other NBER indicators fall—will continue to sustain spending in coming months.

However, because consumer outlays, especially for cars and homes, have remained strong, they will not provide the large push they have supplied in past re-

coveries. Also, past wealth losses and skimpy household savings will further limit any consumer surge in 2002.

Car sales alone in the first quarter will likely drag down overall spending. The fourth-quarter boom in car buying, which continued into November, was fueled by rich incentive programs. It is sure to go bust in the first quarter when the incentives end. Nonetheless, the average level of sales for the two quarters combined should be unusually good for a recession period.

The NBER admitted that the committee considered earlier dates for the recession's start in order to reflect the industrial sector's decline since last autumn. The factory downturn, the sector's worst recession in the postwar era, has been driven by the tech-related bust in capital spending.

The tech wreck points out another big obstacle for the recovery. The economy will not enjoy a strong rebound until companies see business improving enough to shunt out more money for investments in machinery and high-tech gear. Only that can ensure a solid upturn in the industrial sector. So while consumers will be able to lead a modest recovery in 2002, their pull won't be great enough to offset the drags left over from 2001.

CONSUMERS GROW MORE WORRIED ABOUT LAYOFFS



FRANCE

EUROPE'S BRIGHT LIGHT WILL SOON BURN OUT

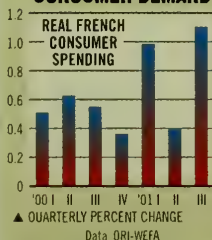
France surprised most analysts by surpassing growth expectations for the third quarter. But the supports for that growth were short-lived. And when compared to a year ago, the economy has slowed to its lowest rate in four years.

Real gross domestic product rose 0.5% from the second quarter to the third, better than the 0.3% projected. Consumer spending soared by 1.1% (chart). But because business investment and foreign demand have been

will struggle to grow 2%. That's because the consumer spending spree was lifted by tax rebates and tax-rate cuts that gave households more income to spend.

These stimulus programs will not be repeated soon.

FISCAL HELP LIFTED CONSUMER DEMAND



sagging all year, French real GDP last quarter stood only 2% above its year-ago level, the slowest annual growth rate since 1997.

Moreover, growth is weakening this quarter, and real GDP in 2002

ating. While overall inflation slowed to 1.7% in the year ended in October, compared to 2% a year ago, nonfuel prices rose 2.3%, much faster than their rate of 1.1% in October, 2000. Weighed

down by rising unemployment and shrinking buying power, consumer demand is dropping. Household purchases of manufactured goods fell 0.4% in October from September, when they dipped 0.1%.

France's economic gain is a bright spot for the euro zone since it offset some of the drag coming from Germany, whose economy hasn't grown since the first quarter. But Germany's woes are hurting French exports, which have fallen for three quarters in a row. And with the U.S. now in a recession, France cannot expect foreign demand to contribute any growth to its economy.

Neither can France depend on any help from the European Central Bank. The ECB indicated it will hold interest rates in the euro zone steady until at least the end of the year.



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A SLOW ROAD TO RECOVERY

But long term, innovation and productivity gains will shape a healthy expansion

COMMENTARY

By Michael J. Mandel

Economies evolve. Change is gradual and often hard to assess while it is happening. That's exactly the situation that the U.S. finds itself in now. On Nov. 26, the National Bureau of Economic Research, the Cambridge (Mass.) economics organization, officially declared that the U.S. had entered a recession as of March. That puts a punctuation mark at the end of the longest expansion on record.

But the recession is a comma, not a period. The New Economy, which started life as a tech-driven boom, has not disappeared. Instead, it's evolving in some surprising ways. In the short run, the U.S. will continue to struggle with the first technology-driven recession. It may not last long—most forecasters expect low interest rates and tax cuts to bring economic growth into positive territory by mid-2002. But with no sign yet of an upturn or even a bottom to the tech-spending dive, any recovery will be anemic (page 27).

Moreover, higher productivity

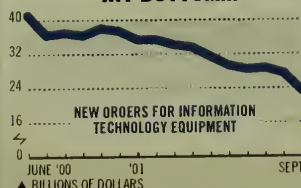
growth, one of the virtues of the New Economy, could actually undermine consumer spending in coming months by driving up unemployment and holding down wage gains. In the past three recessions, productivity fell. But since this recession started, productivity has been rising at a 2.4% annual rate. Why? Companies are making better use of their existing investments in technology even as they restructure their operations for greater efficiency. The combination is enabling them to boost profits by shedding workers. So even if the recession officially ends soon, the U.S. is likely to see months more of rising unemployment and weak growth.

For the long run, the picture is brighter: Economic growth depends on the ability of companies to do exist-

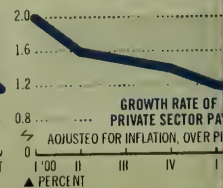
THE GOOD NEWS ON THE RECESSION

Yes, the economy is hurting, and there's more trouble to come. But some surprising signs of underlying strength are laying the foundations for a durable expansion.

TECH HAS NOT HIT BOTTOM...



...WAGE GAINS ARE SLOWING



tasks more efficiently and the willingness of entrepreneurs to create innovative businesses and products. There is no sign that that process has stopped or even slowed. The number of patents being granted is running at an all-time high, and despite the woes of dot-coms, venture capital firms were still investing at a \$30 billion annual rate in the third quarter of 2001. That's way ahead of any year except 1999 and 2000.

The forces pushing innovation argue for growth to accelerate over the next few years as new companies form and new ideas come to market. But the next expansion will likely have a different character than the last one. Information technology will probably never regain the accelerated growth of the 1990s. Instead, there are early signs that innovation in biotech and health care will fuel the next period of growth. In addition, stronger growth overseas may give the U.S. a kick from foreign trade rather than having it be a drag on the economy.

Still, that's little comfort for the short term, which remains gloomy. The past few months have been tough on an already struggling economy. First, the September 11 attacks caused

pullback of capital spending. The telecom industry is awash in capacity, and airlines are cutting back on plane purchases. In manufacturing, which accounts for roughly one-sixth of capital spending, factories are running at only 73% capacity. It would take two years of 4% growth before companies started thinking about adding more capacity. That's as fast as manufacturing grew in 1999.

And while consumer spending has held up surprisingly well so far, it may start flagging soon. American households have benefited from six years of rising real wages. Indeed, workers have steadily claimed an increasing share of national income. The latest figures show that wages and benefits now account for 86% of nonfinancial corporate output, by far the highest level on record. Meanwhile, after-tax profits have fallen to only 6% of corporate output, according to figures from the Bureau of Economic Analysis. That's way below the 10% peak they reached in 1997.

That state of affairs will not persist. In the 1990-91 recession, companies started slashing jobs and holding pay increases below inflation. Even after the recession ended, companies kept the lid on labor costs until healthy profits returned. The unemployment rate rose for 15 months after the recession ended in March, 1991, and real wages fell until 1995. As a result, profits jumped sharply.

The "jobless recovery" may be even more pronounced this time because productivity growth is stronger than it was a decade ago. The current consensus among economists is that business productivity is likely to keep rising at a rate of about 2% annually. Given that the workforce grows at about 1% annually, that means output needs to grow at 3% to just hold unemployment constant. A sluggish recovery, with growth under 3%, would send unemployment soaring—perhaps as high as 6.5% or 7% by the end of 2002. That will hold down consumer spending and slow growth.

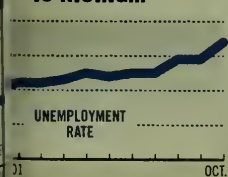
As a result, the Federal Reserve may be forced to keep rates low well after the recession officially ends. That's similar to the aftermath of the 1990-91 recession, when the Fed continued to ease into the fall of 1992. Moreover, the Fed may feel an obligation to keep rates low in order to protect the financial system, which was coming under increasing stress even before the Enron disaster. All but the most creditworthy of borrowers now have to pay a widening premium to account for the possibility of default.

But there is a big difference between stressed and broken, thanks to Federal Reserve Chairman Alan Greenspan's aggressive interest rate cuts. They began in January, 2001, before the recession even started. The willingness of the Fed to keep pumping money into the economy enabled companies and investors to start the process of writing off and absorbing the excesses of the 1990s. With interest rates low and money easily available, it has been much easier to deal with the enormous overhang of bad telecom debt and lost investments in dead dot-coms.

As result, the economy is able enough to deal with finan-

ther damage by hurting consumer confidence, raising business costs, and putting airlines into a tailspin. Now, the rapid deterioration of Enron Corp.'s finances is causing investors to broadly rethink corporate creditworthiness. Nor will the economy be bailed out by the tech sector. Past business cycles suggest that the main driving forces of expansion often lag in the next period of growth. New orders for information-technology gear are still way below where they were just a few months ago. And while Intel Corp.'s CFO announced on Nov. 27 that he is comfortable with his forecasts of Intel's sales so far this quarter, new orders for semiconductor-manufacturing equipment fell 12% in the third quarter. But tech is hardly the only sector to suffer from a broad

UNEMPLOYMENT IS RISING...



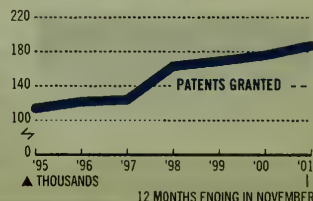
...BUT PRODUCTIVITY REMAINS STRONG...

GROWTH RATE OF NONFARM BUSINESS PRODUCTIVITY

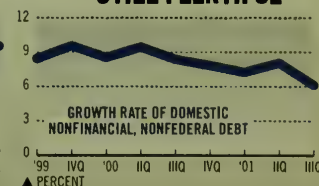
RECESSION	EXPANSION
1973-75	1975-80
0.2%	1.6%
1980	1980-81
-1.2%	2.1%
1981-82	1982-90
-0.2%	1.8%
1990-91	1991-2001
-0.6%	2.1%
2001*	2.4%

*TWO QUARTERS SINCE RECESSION BEGAN

...INNOVATION CONTINUES...



...AND FINANCING IS STILL PLENTIFUL



cial shocks, including the September 11 attacks. What prolongs a recession—and potentially turns it into a depression—is a collapse of the financial system. But that isn't happening in the U.S. Banks are still willing to lend, corporations are still issuing bonds in large quantities, and consumers can still easily get mortgages and car loans.

Even venture capital firms are still pumping money into new companies. And those funds aren't just going to prop up struggling companies. So far in 2001, venture capital investors have funded more companies at the startup and seed stages than ever before—including the boom years of 1999 and 2000. These young companies, which are still very small, could be the foundation of the next boom.

To be sure, it's hard to predict which ones will blossom into the next Internet, powerful enough to propel the entire economy. That's because innovations are fundamentally unpredictable. Thus, virtually every economic forecaster underestimated the growth of investment, productivity, and jobs in the 1990s because they simply didn't see the Internet coming.

Still, it's a good bet that a sector that keeps growing during a recession will help drive the next expansion. During the recession of 1990-91, information-technol-

ogy on government spending. That means it can be slowed by political deadlocks.

Another possible new fuel for the next expansion is foreign trade. In the second half of the 1990s, the U.S. grew faster than the rest of the world, which set up a self-sustaining cycle. Lured by the prospect of higher returns, foreign investors poured money into the U.S.—\$1.4 trillion in five years. That fueled the capital-spending boom and the U.S. stock market. They in turn boosted growth even more, making the U.S. ever more attractive to foreign in-

THE 'NEW' NEW ECONOMY

What the next expansion could look like

NEW SOURCES OF STRENGTH



BIOTECH BOOM?

A decade ago, a surprise surge of high-tech capital investment pulled the economy out of recession. This time, growth will likely come from other sectors, such as biotech or medical care.

STRONG PRODUCTIVITY

Although down from its highs in the recent boom, long-term productivity growth should run around 2%. That should allow the economy to grow at roughly a 3% clip—a half-point higher than GDP growth prior to the New Economy expansion.

SLOW JOB GROWTH

But the continued productivity gains mean companies will be able to expand without adding new workers. So unemployment may keep rising well after the recession ends.

ogy investment, adjusted for inflation, barely dipped. That was a

vestors. Meanwhile, imports far outstripped exports, turning trade into a drag on growth.

This time around, the dynamic could be quite different. The U.S. economy is being held back by the capital-spending bust. Moreover, countries such as Britain and Germany have made strides in opening their markets to foreign competition. As a result, economists at Merrill, Lynch & Co. forecast that the European Union will grow at almost double the U.S. rate in 2002. Asia, outside of Japan, could grow faster than the U.S. as well, with China and India expected to turn in 7%-plus growth rates. Such faster growth overseas could turn foreign trade into a boon for the U.S. economy.

To be sure, no one yet knows what the next expansion will look like or when it will arrive. But thanks to continued productivity growth and innovation, at least we can be sure that one is on the way.

A REBOUND IN PROFITS

Job cuts and falling real wages, together with strides in productivity, should give corporate profits a strong boost sometime in 2002.

IMPROVED TRADE

Faster growth in Europe and Asia, compared with the U.S., could help narrow the U.S. trade deficit.



ASIA MAY BUY MORE U.S. GOODS

HIGHER SAVINGS RATE

The flow of money from foreign investors will slow. Instead, the U.S. will have to fund capital spending by increasing its savings rate.



JOBLESSNESS WILL HURT CONSUMPTION

sign of strength for the future, showing that companies and consumers put a high priority on information-technology spending even as the economy slowed.

This time around, health-care spending has stayed strong through the downturn. That argues for health care, led by biotechnology, to emerge as one of the driving forces in the next upturn. By contrast, medical spending growth slowed sharply in the last two recessions.

An expansion driven by health care would be very different than one driven by information technology. Instead of boosting productivity, medical innovation would have much more of an impact on improving longevity and quality of life. These are not aspects of the economy that are well measured by GDP. The other difference is that unlike technology investment, health-care spending depends close-

Chief Economist Mandel covers the New Economy

HOT SPOTS IN A COLD JOB MARKET

Some laid-off workers are
finding new jobs—fast

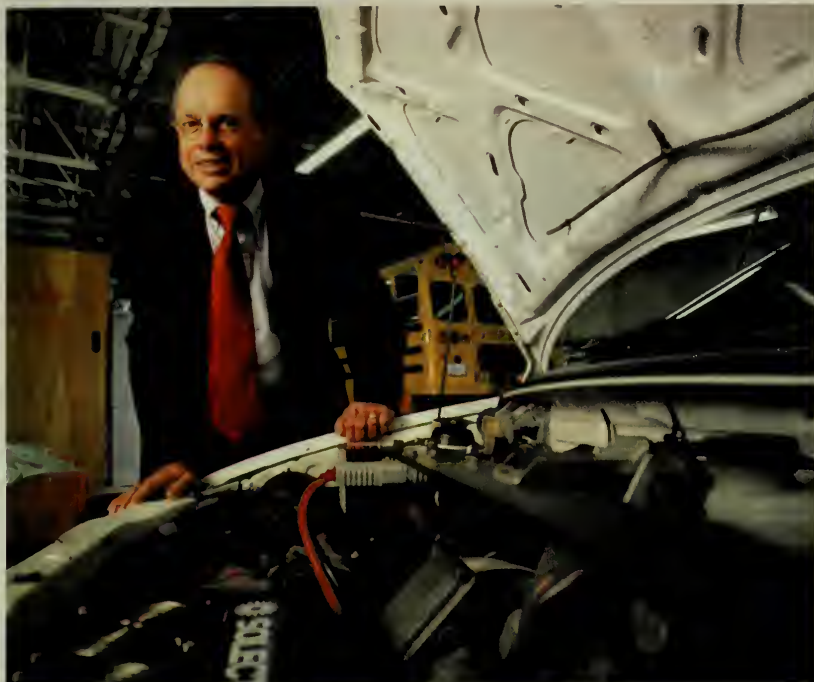
Bill Connors was worried sick when he lost his job in late September overseeing the inspection of cell-wire parts. Where would a 54-year-old career telecom executive find a job in an economy that was souring? After his résumés went unanswered in the first four weeks of his job search, Connors turned to online job board Monster.com. A day later he found a new job with better pay. Now he manages quality control at Boston's Solectria Corp., which makes parts for electric vehicles. "In this job market, you have to be flexible. Look outside your field if you're going to find work," he says.

Connors isn't the only laid-off worker to find himself rehired sooner than expected. While the U.S. recession has sent unemployment up sharply in almost every region and industry, plenty of workers seem to be snatching new jobs without much trouble. The reason: Even as many companies have begun hiring freezes, lots of enclaves remain in which companies are now happily cherry-picking among the newly unemployed. "There are a surprising number of pockets of strength in this recession," says Mark Vitrer, economist at Charlotte (N.C.)-based bank Wachovia Corp.

Of course, layoffs remain the rule. The U.S. shed 415,000 jobs in October, the biggest single monthly job loss in 20 years, according to the Bureau of Labor Statistics. After hitting an all-time low in October, 2000, of 3.9%, unemployment has spiked up 5.4% in just a year.

Together, 1 million fewer jobs exist in the U.S. today than last October. The boom industries of the late 1990s, such as telecom, computers, and consulting, have been hit especially hard. "This is the worst I've ever seen for out-of-field consultants," says Adam P. Kohn, managing director at headhunter Christian & Timbers.

On average, that means the time it



WIRED: Bill Connor got work one day after turning to an online job board

now takes to snare a new job—7.4 weeks, the BLS says—is growing. While far less than the 10 weeks it took in the mid-'90s, that's a big rise from the 5.3 weeks required in September, 2000.

Yet the weakness is far from universal. Nationally, state education jobs increased 140,000 between October, 2000, and October, 2001 (page 53). Although Texas employment has fallen overall, the booming oil sector lifted hiring in Houston by 2.2% in September. In still-hot industries like bioscience, workers continue to flit among jobs. "I've been impressed with the number of positions available in the pharmaceutical industry," says Dr. Vanaja V. Raghavan, who just jumped from Aventis to Novartis to head up women's health research.

Even in hard-hit industries, some growth remains. While tech hiring is down overall, Microsoft Corp. plans as many as 5,000 hires this fiscal year to design, test, or sell software. And though tens of thousands have lost their jobs on Wall Street, many banks and investment houses continue to hire. Despite a spate of recent layoffs, both FleetBoston Financial and Fidelity Investments have recently been in the market again. They've posted 850 jobs online for everything from secretaries to accountants.

"Investment bankers have been hit hard, but [many others in] the industry are doing fine," says Bill Coleman, vice-president for compensation at online job service Salary.com Inc.

In fact, some industries aren't hurting as badly as it might seem. Depressed as the financial and telecom sectors are, jobs in each grew 1% and 1.4%, respectively, between October of this year and last. Even the troubled retail sector has seen gains. Not only have enough new jobs been created to make up for all the layoffs in each sector, additional jobs have been created.

BALANCING OUT. Still, a looser labor market means that after years in which job seekers held the upper hand, the balance of power has swung back to employers. Now they can pick and choose among the many job seekers, snatching up veterans like John Athanasos. The 34-year-old promotions manager was laid off from Silver Springs, an Ocala (Fla.) nature park, days after the attack on the World Trade Center. With extensive expertise, he quickly drummed up several job offers.

But even a great résumé isn't a guarantee these days. "Companies are hiring fewer people and are being more picky," says Patrick Sylvester, a managing director at executive search firm Banister International Inc. For now, however, folks that don't make the cut in one industry may find their luck better—and faster—in others.

By Charles Haddad in Atlanta, with bureau reports

HELP STILL WANTED

Healthy job gains continue in some fields

INDUSTRY	JOBS CREATED SINCE OCT., '00*
RETAIL TRADE	61,000
FINANCE, INSURANCE, AND REAL ESTATE	64,000
CONSTRUCTION	74,000
SERVICES	228,000
HEALTH SERVICES	282,000
GOVERNMENT	446,000

*Seasonally Adjusted Number of Employees, Oct. 2001 vs. Oct. 2000

Data: Bureau of Labor Statistics

THE PRESIDENCY

THE TRICKY BUSINESS OF BEING MR. POPULARITY

Pleasing the Right could alienate Bush's newfound fans

Like father, like son. A decade ago, in the afterglow of his gulf war triumph, President George Bush's approval rating stood at 91% in the polls. Now, President George W. Bush, flush from success in Afghanistan, boasts the longest run of job-approval ratings above 80% in modern history. Like his dad, the younger Bush has accumulated vast amounts of goodwill. "There's not a vault large enough to hold his political capital," marvels Democratic consultant Dane Strother.

But what to do with it? Presidential advisers say Bush Jr. is haunted by his father's precipitous decline in public esteem following Kuwait's liberation. The senior Bush squandered his capital by flip-flopping on his promise not to raise taxes. He then lost the election when voters blamed him for not doing enough to right a sour economy. "The biggest lesson from Dad is: Use your capital wisely and don't fritter it away," says University of Texas political scientist Bruce Buchanan.

DORMANT. For the current President, that means some tough political calculations. While he has won praise across the political spectrum for his military and diplomatic achievements, Bush hasn't articulated a strategy for fighting recession or devised a domestic agenda beyond his 2000 campaign promises. For the time being, the White House plans to parcel out small amounts of political capital to complete a domestic agenda that has been largely dormant since September 11. Returning from Thanksgiving weekend, Bush told his staff he wanted to complete several unfinished items on his legislative to-do list, from oil drilling to trade liberalization to a more moder-

ate version of his faith-based initiative.

Lightning-rod issues, such as Social Security reform and overhauling the tax system, will stay on the back burner as the White House tries to consolidate Bush's newfound support among swing voters. He's "governing in a way that won't antagonize the 80% support he has," says Stephen Moore, president of the supply-side Club for Growth. "He fears that if he starts being partisan, his support will go back down to 51%."

Problem is, political popularity is a highly perishable commodity. If he continues his bipartisan outreach of the past two

months, Bush risks alienating conservative Republicans on Capitol Hill who consider any compromise with Democrats sign of weakness. And if he embraces his right wing, he'll lose the backing of new centrist supporters. What's more, an unexpectedly nasty recession or other terrorist strikes in the U.S. could change the political landscape once again.

White House political advisers are walking a fine line. For the first eight months of Bush's Presidency, they pursued a rightward tilt, trying to mollify the Republican Right. But they now see an opportunity to attract more Independents and Democrats. Bush's job approval among Democrats of all stripes has already soared.

To keep newfound fans in the fold without alienating the hard core, the White House is hatching a series of careful compromises. Bush's original faith-based initiative, for instance, angered many Democrats because they saw it as a clear case of mixing church and state. Now, though he will not lose some support on the far right, the President is close to a compromise with Senator Joseph I. Lieberman (D-Conn.) on a trimmed down version. "Bush is driving the train right now," says Senator Rick Santorum (R-Pa.), a leading proponent of the bill.

The President will take a harder line on another top priority: trade liberalization. He is planning to confront leaders of the Democratic Party and some America Firsters in the GOP, by insisting on a final vote on the long-delayed legislation to restore speed to Presidential trade-negotiating authority. With a December showdown vote looming in the House, the President has been trying to persuade undecided Democrats and Republicans to stand with him. But Bush's stout support for free trade is likely to alienate some union members who strongly back his military action.

Another unfinished Bush priority:



Riding a Wave

	SEPT.
LIBERALS	28%
INDEPENDENTS	44
MODERATES	47
CONSERVATIVES	87
WOMEN	47
AGE 65 AND OVER	44

energy legislation. The Administration and the oil industry allies say the war on terrorism has made the public far more willing to expand production at home. There's an increased recognition on the part of the American public that we need to increase domestic supply," says Red Havaney, president of the American Petroleum Institute. He may have a point: According to a Nov. 9-12 Ipsos-Reid survey, 67% of Americans favor new energy exploration, even in Alaska's Arctic National Wildlife Refuge. Still, Bush's big push for more drilling could lower his ratings of support among pro-environment independents and suburbanites. That could be why Senate Majority Leader Tom Daschle is delaying consideration of the energy bill until 2002.

BUSHFIRES. The White House also will have to expend capital to put out some political brushfires. On Capitol Hill, Democrats have tied up spending and tax bills while holding out for a second budget summit—something the White House is loath to do. Democratic strategists think they can dent the President's mor by portraying Republicans as tools of Corporate America for pushing a second tax cut weighted toward business the guise of "economic stimulus." Remembering the fate of the first Bush, the White House wants to be seen as doing something to jumpstart the economy and assist unemployed workers. Still, any likely compromise may end up disappointing Bush's corporate allies.

Elsewhere, though, Bush's domestic agenda remains largely unformed. Cash-in on his popularity may be vital maintaining it. One possible role model: Franklin D. Roosevelt. "The more we were able to accomplish legislatively, the easier it was to get even more of the New Deal enacted," says Moore. "The more successful he became legislatively, the more popular he became." That's a better model than Bush Sr. The President will never have as much leverage as he has now. But it's his political skills inside the Beltway—not the exploits of the U.S. military—that will decide whether that capital is well spent. *By Richard S. Dunham, with Lorraine Ellert and Laura Cohn, in Washington*

War against terrorism has sent President's popularity soaring

	SEPT.	NOV.
AGE EDUCATED	48%	85%
\$50,000 INCOME	50	89
WIVES	52	87
TERS	52	80
	51	87

Only 1,000 people polled who approve of the job Bush is doing
Data: Gallup Poll

COMMENTARY

By Catherine Arnst

A BAN WON'T MAKE CLONING GO AWAY

The destiny of mankind may have just been rewritten. The news that Advanced Cell Technology Inc. of Worcester, Mass., has created the first cloned human embryos marks rapid progress on a technology that holds huge potential—and danger—for our biological future. How that future will play out, however, depends far more on politicians than scientists.

A total ban, as called for by President Bush, would only drive the research overseas, where it could evolve with little or no oversight. Regulating the technology—as in Britain—is far preferable, though no slam dunk. Any legislation addressing this complex process will require a degree of scientific sophistication that Washington has rarely displayed.

First and foremost, politicians and the public must understand the difference between cloning for therapeutic vs. reproductive purposes. Advanced Cell, and most responsible scientists in this field, want to clone human embryos only to create a source of embryonic stem cells, the all-purpose precursor cells that may hold the key to cures for many tissue-destroying illnesses. The clones would be destroyed before they become viable embryos capable of growing into humans. To ensure that outcome, laws—backed by harsh penalties—must bar cloned embryos from being implanted in a womb, real or artificial.

Ethical absolutists will argue that once we allow cloning, even for therapeutic purposes, there'll be no turning back. "They are right. It is the start

of the slippery slope," says George J. Annas, chairman of the Health Law Dept. at Boston University. "But the proper laws should be able to control the slide."

Britain points the way. There, the Human Fertilization & Embryology

Authority licenses all research into embryos and all fertility clinics, which are virtually unregulated in the U.S. It's a crime to create an embryo outside the body without a license. Legislation is pending that will clearly ban reproductive cloning while allowing therapeutic cloning.

"We've taken a very considered view, and it has been very useful for scientists because they

know where they stand," says Christopher Higgins, director of the Medical Research Council's clinical sciences center at London's Imperial College.

The U.S. should take a similar approach. Senate leaders moved in the right direction by blocking an immediate vote

“It is the start of the slippery slope. But the proper laws should be able to control the slide”

GEORGE J. ANNAS

Ethicist and chairman of Boston University's Health Law Dept.

on the cloning ban passed by the House in August. Senator Arlen Specter (R-Pa.) has also argued, wisely, that scientists must be allowed to present their case to Congress.

But a reasoned approach should not equal doing nothing. Washington may dither, but scientists won't, and our chance to control the technology could be lost. "For the best of reasons, or for the worst of reasons, cloning efforts are going to go ahead," says David J. Roth, professor of social medicine at Columbia University Medical School. Let's make sure it's for the best.

With Kerry Capell in London



COMMENTARY

By Mike McNamee

TERROR INSURANCE: HOW TO STOP THE COMING CRISIS

Insurance companies aren't winning many plaudits as model citizens these days. In the wake of September 11, they jacked up premiums on all sorts of businesses far from the World Trade Center, including 300% increases on trucking companies and 400% increases for real estate developers. With the promise of profits from those steep hikes, they've wooed billions in new capital. All justified, perhaps, if the river of cash was flowing into a piggy bank for damages from future terror attacks.

But that isn't the case. Instead, insurers insist that Washington must take over the risk of covering any future attacks, to the tune of up to \$80 billion. Little wonder that Congress has choked on making Uncle Sam the industry's deep pocket.

Trouble is, there's more at risk than insurers' balance sheets. Without terrorism coverage, real estate development, manufacturing, and transportation could effectively be shut down when many current policies expire on Jan. 1. So it's vital that Washington put a terrorism backstop in place. But tough love—not a bailout for insurers—ought to be the goal. Congress should do only what's necessary to give the economy the safety net it needs, without sticking taxpayers with all the risk or padding carriers' swelling profits. **"OBVIOUSLY HARMFUL"** At the heart of the problem: States can force primary carriers to write terror policies, but they have no such reach over reinsurers—the companies that insure primary carriers. The reinsurers say they'll quit covering terror risks at the end of the year on the 70% of their policies that expire. That's why

Congress' stalling is panicking business. "We can't fathom how Congress could fail to act on something so obviously harmful to the economy," says Tony M. Edwards, general counsel of the National Association of Real Estate Investment Trusts.

What will it take to get insurers to willingly cover terrorism again? One key is a predictable cap on losses. The Bush Administration and the Senate call for the industry to pick up the first \$10 billion a year in terrorism damages. A hefty "deductible" will give insurers a strong incentive to enforce tight security and risk-reduction on their clients.

To restore coverage for high-profile businesses, the plan must also limit individual insurers' risks. No carrier will insure a high-risk property if a loss of, say, \$3 billion would wipe out the company before government aid kicks in. A viable cap would limit the insurer's exposure to about 5% of its premium or 10% of its capital. The House bill, scheduled for a Nov. 29 vote, offers such a mix.

For damages over \$10 billion, Washington will finance 80% or 90% of losses. But that aid shouldn't be a giveaway, as the White House proposed. Instead, insurers should pay back the government through assessments on all commercial property premiums. Stiff enough assessments would make reinsurers reconsider covering terror.

If terror attacks cause \$100 billion in damages—almost twice the cost of September 11—the initial bill to taxpayers could hit \$80 billion. But whatever taxpayers spend, they should



eventually be reimbursed, even if it takes a decade to do so. Only if damages exceed \$100 billion should Uncle Sam pick up all the cost.

Unfortunately, terror insurance is also entangled in the never-ending battle between business and trial lawyers. Business wants the insurance plan to limit lawsuits and punitive damages due to terror attacks. "If everybody is going to pay more, it's only reasonable to put limits on liability," says James Wootton, president of the U.S. Chamber of Commerce's Institute for Legal Reform. Lawyers and their Democratic allies have the Senate votes to block any plan that wipes out punitive damages. But business and the White House should hold out for some lawsuit limits, such as consolidating all cases in one federal court.

With lawmakers hoping to adjourn by mid-December, time is running out. Congress has all the pieces it needs to construct a sound safety net for terrorism risks. All it needs now is to get moving.

McNamee covers finance from Washington

COVERING TERRORISM

The government's plan to backstop insurers should include the following:

DEDUCTIBLES

By requiring the industry to pay up to \$10 billion in damages, the U.S. will encourage them to promote tighter security.

REPAYMENT BY CARRIERS

To avoid padding carriers' profits, the U.S. should charge premiums. That way taxpayers recapture the cost of protecting insurers.

LIMITS ON LAWSUITS

Caps on punitive damages may not be possible. As a compromise, claims should be consolidated in one federal court.

PROFIT INCENTIVE

The carriers' backstop should be expensive and stringent enough to encourage private reinsurers to compete to cover terror risks.

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THE WAR ON TERROR

ENDGAME IN AFGHANISTAN

On the ground and at the table, it looks to be a lengthy drama

With his attention shifting from a nearly liberated Afghanistan to a defiant Iraq, George W. Bush on Nov. 26 issued a sweeping declaration of U.S. intentions in the war on global terrorism: "Afghanistan," the President said, "is just the beginning," and left it to Iraqi strongman Saddam Hussein to fill in the blanks. But despite this well-scripted show of bravado—largely an attempt to rattle the Iraqis and stoke Allied support for sanctions against a regime intent on developing nuclear, chemical, and biological arms—the fact is that Bush is a long way from taking a victory lap around Baghdad. He's still hip-deep in the Afghan campaign, and likely to remain preoccupied for months with the chore of shutting down the Al Qaeda terror network.

That might strike some as odd, given the Allies' rapid progress in knocking out the Taliban militia. But in reality, the Afghan endgame figures to be a demanding drama, one that now shifts from uprooting the Taliban to the tricky business of simultaneously crafting a broad-based government in Kabul while putting U.S. troops at the forefront of the hunt for Osama bin Laden. As a result, the denouement of the American intervention may not be as fast-paced or satisfying as that boffo Act I, something Bush hinted at when he cautioned that the campaign was entering "a dangerous period."

On both the military and political fronts, difficult days lie ahead. For the first time, U.S. Marines are on the ground in Afghanistan. And for the first time, representatives of Afghanistan's feuding factions are sitting around a conference table under the watchful eye of the big powers. On Nov. 27 in Königswinter, outside Bonn, four Afghan delegations convened the first of a series of peace gatherings. The goal: agree-

ment on a transitional regime and discussions about the need for a multinational security force from Turkey and other Islamic nations.

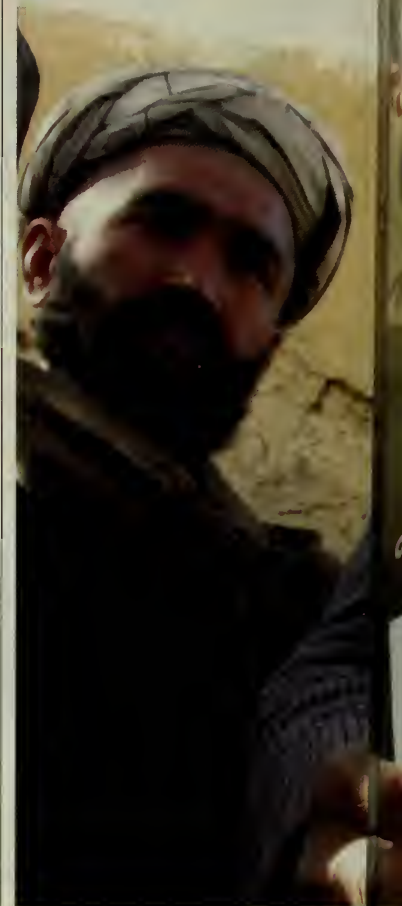
In Germany, Allied observers looked on as delegates for the largely Tajik, Uzbek, and Hazara Northern Alliance huddled with Pakistan-based delegates seeking to speak for the Southern Pashtuns, an ethnic grouping representing 43% of Afghanistan's population. But other prominent Pashtun leaders were otherwise engaged, battling to secure



Kandahar and a seething triangle of southern Afghanistan. Also at the table in Germany: a Rome delegation loyal to ex-King Mohammad Zahir Shah, considered by the Allies as a key unity figure; and the Cyprus Group, a cadre of largely Shiite exiles allied with Iran.

It only took the disparate band of Afghans a little over a day to reach a basic agreement on allowing the exiled king to serve as a titular leader of a new government. Although details were still being hammered out as *BusinessWeek* went to press on Nov. 28, plans called for the 87-year-old monarch to serve for two years or so while a new constitution is drafted and more specific power-sharing formulas are drawn up. Sometime next spring, Afghans would convene a *loya jirga*, or grand gathering of elders, to hammer out details of tribal representation.

If it stands, the deal marks a turning point for postwar Afghanistan. For starters, it represents a major conces-



TWO FRONTS

The search for bin Laden will take time, as will implementing a deal made in Bonn

sion for the Northern Alliance to agree to the king's return. Moreover, after more than two decades of war, some Afghan commanders may recognize time to rebuild first, reload last. "There's a tremendous war-weariness," says a senior U.S. official in Bonn. "Further inducement, the Allies are bating the prospect of massive aid."

But several thorny issues remain, including what to do about the Afghan fighters who have been deserting in droves. Initially, the Northern Alliance ruled out a Taliban role in a new regime. But now some elements of the former government may end up in the new coalition—which would please Pakistan, the Taliban's erstwhile backer. Tal-

PHASE TWO

With the war in Afghanistan grinding to a finish, huge issues remain to be resolved



in leaders who defect "are entitled some consideration," says a senior Washington official. "If they start helping, they earn even more chits." Despite such U.S. overtures, Pakistan sees the emerging shape of postwar Afghanistan with growing alarm. The U.S. in Germany have provided little space for President Pervez Musharraf. That's because he has been relegated to making a weak group of Pashtun exiles based in Peshawar. "Pakistan," says one American official, "is desperately looking for a voice in Afghanistan." But Pakistan may not face the abyss one forecast. If stability is restored in Afghanistan, many of the 2 million Afghans in Pakistan may go home, easing the political and economic strain.

And for however long calm reigns, landlocked Afghanistan will need Pakistan's trade routes to the Arabian Sea. That means a possible strengthening of economic ties between the two neighbors.

With events moving faster than anyone expected, Pentagon planners are focusing on the key aim of the campaign: capturing or killing bin Laden & Co. One hope is that a \$25 million bounty placed on bin Laden's head will prompt someone to simply hand him over. The less palatable alternative is a risky search of the network of caves where he could be holed up. "A major firefight may be needed to get bin Laden," says Michael E. O'Hanlon, an analyst at the Brookings Institution. "We could lose [a lot of] Marines." And there remains

the admittedly small chance that the ongoing operations in Afghanistan could bog down.

Whether the climax is attenuated or sudden, American officials who once feared years of Afghan involvement have been growing increasingly confident that within a year or less, Al Qaeda's nerve center will be knocked out. That's when the Administration will face a key decision: stop there, or take the war on terror to Somalia, the Sudan, the Philippines, and, eventually, Iraq.

SOMALIA NEXT? Already, there is talk that the U.S., allied with Ethiopia and friendly African nations, might tackle Al Qaeda forces in Somalia next. So long as the U.S. provides credible evidence that Al Qaeda is operating in Somalia or elsewhere, Bush can likely count on some multinational support. All bets are off, however, when the subject turns to Iraq. The Russians, French, and Chinese—all permanent members of the U.N. Security Council—are uncomfortable with the idea of a military assault on Baghdad. Nor would such an operation go over well in the Arab-Muslim world.

Despite such obstacles, Bush has upped the rhetoric against Saddam Hussein. By calling for a resumption of U.N. weapons inspections, the President is trying to spur Allied support for his "smart sanctions" policy. The goal is "to bring pressure to bear [on Iraq] in a much more focused way," says Sir Timothy Garden, a retired Royal Air Force General now with London's Center for Defense Studies.

The betting is that Bush will put Iraq on the back burner for now. His Administration will be preoccupied for the time being with finishing the job in Afghanistan and foiling more terrorist attacks from sleeper Al Qaeda agents. But that doesn't mean the President has put the Iraqi problem out of his mind. Eventually, aides say, Baghdad will enmesh Bush and his war planners again—and revive 10-year-old memories of scores to settle and promises to keep.

By Lee Walczak, Stan Crock, and Paul Magnusson in Washington and Frederik Balfour in Islamabad, with bureau reports

RECONCILIATION

Representatives of several Afghan factions in Germany to endorse exiled King Mohammed Zahir Shah as an interim leader. The table: Laying the groundwork for a tribal council, which would develop a power-sharing formula. But while the war-weary, enmity runs deep, agreement may prove elusive.

ousting OSAMA

As the U.S. and its allies continued to root out Taliban resisters in Afghanistan, the focus shifted to capturing or killing Osama bin Laden. The U.S. put a \$25 million bounty on bin Laden's head in hopes of prompting his speedy handover. Equally likely was a risky cave-by-cave hunt for the Al Qaeda supremo that could result in U.S. casualties.

WHAT ABOUT IRAQ?

As Bush ratchets up the anti-Iraq rhetoric, some allies in the war on terror—Russia, France, and China—remain uncomfortable with the idea of a military strike on Baghdad. In fact, the U.S. seems unlikely to start a war with Iraq anytime soon. Rather, Bush's saber-rattling appears intended to pressure U.S. allies to tighten the sanctions noose around Iraq.

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EDITED BY MONICA ROMAN

MICROSOFT TO EUROPE: LET'S TALK

MICROSOFT IS HOPING THAT ITS successful strategy of negotiating with the government can be replicated in Europe. On the heels of its deal with the Justice Dept., the company signaled a desire to settle an antitrust case brought by the European Union. Microsoft said on Nov. 28 that it no longer wants a hearing to present its arguments. And company lawyer Bill Neukom has been crisscrossing the Continent, making the argument that the U.S. settlement provides the blueprint for a deal in Europe. Microsoft rivals remain confident the strategy won't work. They argue the company canceled because it wasn't prepared for the hostile questions it would face.

Back in the U.S., nine state attorneys general have decided to press their own case for tough restrictions on Microsoft, rather than direct-

ly challenge Justice's settlement. That job will be left to Microsoft competitors.

PHARMACIA FARMS OUT MONSANTO

PHARMACIA IS LOOKING TO streamline. On Nov. 28, the drugmaker announced that it would spin off to shareholders the roughly 85% stake it still holds in agricultural company Monsanto in the second half of next year. Pharmacia, based in Peapack, N.J., bought Monsanto in 2000 in order to nab the company's drug unit. The deal paid off with the success of Celebrex, the blockbuster arthritis drug developed by Monsanto. But Pharmacia has had little interest in the agriculture business, selling a 15% stake in Monsanto's ag operation in an initial public offering shortly after the 2000 deal.

THE BURDEN GROWS HEAVIER AT LLOYD'S

THE SEPTEMBER 11 TERRORIST attacks are expected to cost Lloyd's of London some \$2.7 billion, 45% more than initially reported. Lloyd's attributes the increase to new property claims and smaller-than-expected recoveries from reinsurers. Although September 11 represents the single biggest loss in the 300-year history of Lloyd's, the world's largest insurance market is adamant that it can manage. Lloyd's is "turning the corner rapidly," according to Chairman Saxon Riley. Lloyd's net premium income underwritten through October is up by \$1.3 billion, to \$4.3 billion. Lloyd's has called for nearly \$1.5 billion in cash from its corporate investors and members, who are known as "names," and it plans another cash call in February. Lloyd's says it doesn't expect to raise this estimate "substantially."

HEADLINER: STEPHEN WOLF

PILOTING US AIRWAYS... AGAIN

US AIRWAYS CHAIRMAN Stephen Wolf has piloted several financially turbulent airlines to profitability. But now he's facing his biggest challenge yet. On Nov. 27, US Airways Group announced that CEO Rakesh Gangwal was leaving to pursue a career in venture capital. Wolf will step back into the top job, which he gave up to Gangwal in 1998. Some analysts speculate that Wolf's new post might be temporary, since he has long left most day-to-day operations to Gangwal.

Under the pair, US Airways agreed to be acquired by United Airlines, but the

\$4.3 billion deal was shelved in July after it failed to pass muster with regulators. After September 11, US Airways laid off 11,000 employees, and it's not clear how much maneuvering room Wolf has. He has arranged a sale at each of the three airlines that he has run in the past, but finding another buyer could be tough. US Airways claims to be financially sound and will end the year with \$1 billion in cash. With the industry's highest operating costs and mounting losses—it lost \$766 million in the third quarter—that money may not last long.

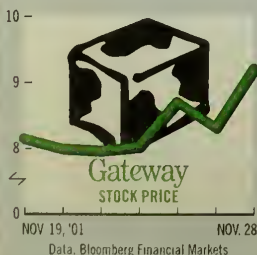
Lorraine Woelken



CLOSING BELL

HOLIDAY RUSH

Reports of better-than-expected computer sales over Thanksgiving left Gateway with something to be thankful for: Its shares jumped 11.2%, to \$9.25, on Nov. 28. But the holiday cheer may prove short-lived. After undergoing a major restructuring, Gateway is still struggling to return to profitability.



AOL'S SPRINT INTO LONG DISTANCE

SPRINT AND AMERICA ONLINE announced on Nov. 27 a new strategic relationship that will offer AOL members a variety of Sprint long-distance plans. Under the multiyear, multimillion-dollar exclusive deal, the online giant will promote Sprint's long-distance phone service on its Web site. The service plans, branded "AOL Long Distance provided by Sprint," will be available for as little as \$5.95 a month. The pact gives Sprint, whose third-ranked long-distance business faces emerging competition from regional bells, an opportunity to reach millions of new customers.

PROVIDIAN'S NEW PRINCE OF PLASTIC

HOPING TO SALVAGE THEIR troubled credit-card giant, directors of Providian Finan-

cial on Nov. 26 tapped Jose Saunders, 56, to succeed Shailesh Mehta as CEO of the nation's fifth-largest card company. Saunders, CEO of the credit-card unit at Fidelity Boston Financial since 1994, faces a tough job. Providing whose stock has fallen 9% since July, to under \$4 share, said federal regulators have prohibited it from issuing credit cards to consumers with poor credit history. Saunders said he will sell billion in high-risk receivables, cut expenses, and focus on higher-return businesses.

ET CETERA...

- Andreas Schmidt, the head of Bertelsmann's e-commerce arm, is leaving the company.
- CSFBdirect, the online brokerage service, was sold to Bank of Montreal.
- IBM is firing about 1,000 U.S. workers in its semiconductor business.

EDITED BY RICHARD S. DUNHAM

THE NUCLEAR WASTE DEBATE: ALL OVER BUT THE SHOUTING?

Mention the words "Yucca Mountain" to Senate Majority Whip Harry M. Reid, and you can expect an earful. For 14 years, the Nevada Democrat has been using every bit at his disposal to prevent the government from opening nuclear-waste storage site beneath an isolated mountain 100 miles northwest of Las Vegas. And Reid's powers are considerable: He is the No. 2 Senate Democrat and controls the object's purse strings as chairman of the Senate Appropriations Committee's energy subcommittee.

But Reid's mission may soon be all but impossible. The reason: Post-September 11, there's growing support on Capitol Hill to safeguard 45,000 tons of radioactive nuclear waste lying idle at 103 nuclear power plants pending the opening of a national repository. While the tunnels were designed to withstand earthquakes, tornadoes, floods, and sabotage, experts worry at the waste could become a target of terrorists. "Now, there's a clear advantage to moving spent fuel to a geological repository," says Paul L. Leventhal, president of the Nuclear Control Institute, a nonpartisan research center. "Once you get it inside the mountain, it's safe from what humans could do to it."

AND OFF. In wartime Washington, such security worries are overshadowing long-held environmental concerns. That complicates matters for Reid, who has been fighting plans to use the hazardous refuse in his state since the site was first authorized for study in 1987. Congress ordered the feds to begin transferring spent fuel to a repository by 1998, but Reid delayed the project—despite the expenditure to date of nearly \$4 billion for research and development. Even before September 11, the political climate had begun to change. Unlike the Clinton Administration, the Bush White House use strongly backs the project and argues that opening Yucca Mountain is crucial to building up America's nuclear-

power capacity—a key to energy self-sufficiency. The Energy Dept. is expected to formally recommend Yucca as the nation's nuclear waste dump this winter. "In Nevada, there is a growing sense that this will happen," says Richard Siegel, a political science professor at the University of Nevada at Reno. "After all, there is no alternative plan."

TRAVEL RISK. Reid isn't giving up. He has the backing of the gaming industry and Senate Majority Leader Tom Daschle—who vows to kill the project. Plus, he has a national-security argu-

ment of his own: Radioactive byproducts would be shipped through 43 states. "Nuclear waste isn't going to suddenly appear at Yucca Mountain overnight," says Reid. "It has to be hauled on the highways and the railways of this country. There are more than 50 million people living along those highways and railways. They're all afraid of this. And now, with September 11, people are even more frightened."

Reid's last, best chance to block the deal could come next summer, when Congress is expected to have an up-or-down vote on the project. Environmentalists will blitz the Hill, arguing that Yucca's proximity to earthquake faults could cause groundwater contamination if a tremor occurs. So despite the new political dynamic, Yucca supporters aren't taking victory for granted. "Harry Reid is going to be a formidable opponent," says R. Bruce Josten,

top lobbyist for the U.S. Chamber of Commerce.

That is undoubtedly true. But Reid must manage to convince his colleagues that ferrying waste to one facility—where it will be buried in metal casks encased in multilayered, corrosion-resistant packaging stored in tunnels 1,000 feet below the mountain—is riskier than long-term storage at nuclear plants. That would have been tough even before September 11 demonstrated that terrorism can happen here.

By Laura Cohn



YUCCA: \$4 billion so far

CAPITAL WRAPUP

SO MUCH FOR HEDGING BETS

Now that the Democrats are out of the White House, business is abandoning the old game of playing both sides of the political fence. In the first six months of 2001, corporate interests funneled \$49.9 million of soft money to Republican coffers while giving just \$19.7 million to Democrats, according to a Common Cause study released on Nov. 27. The most lopsided donor: automotive interests, which sent more than \$1 million to GOP and only \$6,750 to Dems.

HIGH TECH: FRIENDLY FIRE?

► Are Pentagon hard-liners capitalizing on September 11 to push for tighter curbs on high-tech exports? Industry executives believe the tougher stance is behind the slower pace this year of export-license approvals for dual-use goods to China. During the 2000 campaign, George W. Bush vowed to ease curbs on exports of electronic goods that are readily available overseas. If he reverses course, U.S. computer and semiconductor equipment makers could lose ground globally, executives worry.

EXTRA SPECIAL INTERESTS

► Lobbying is all about access, so it's no surprise that new security at the U.S. Capitol and its office buildings is tripping alarms along K Street. The American League of Lobbyists—the lobbyists' lobby—wants special IDs to ease entry to the Capitol and lawmakers' offices. That would let influence-peddlers skip long lines of tourists at checkpoints. "I'm standing behind the Patuxie Ladies Bowling League," complains ALL President James J. Albertine. "A lobbyist can't operate that way."

JAPAN

GAIJIN AT THE GATE

Tim Collins' \$2.5 billion bet on Japan

Whenver Timothy C. Collins visits Japan—which these days is often—he's a whirlwind of activity. Meetings with Cabinet ministers and bigwigs of the ruling Liberal Democratic Party. Get-togethers with the high and mighty of Japan Inc. Number-crunching meetings with prospective partners at Japanese companies.

Collins wants to be the best-connected gaijin there, an insider in a system where insider status counts for everything. He is betting almost \$2.5 billion of his investors' money that the nonstop networking will—improbably—pay off big. You see, to the founder and chief executive of private equity fund Ripplewood Holdings LLC, Japan is the ultimate restructuring play, "Japan has one of the most productive industrial infrastructures going," says Collins. "It has the best engineers in the world, the best products, the best processes." In other words, Japan is a buy.

Although Collins has his admirers, plenty of Westerners think it's nuts to

be bullish on Japan. Japan's banks have more than \$1 trillion in bad loans. The economy is entering its fourth recession in a decade. Multinationals such as Merrill Lynch & Co. have lost buckets of money in Japan.

A TARGET. Yet Collins, far from his Kentucky home—Ripplewood was the ancestral tobacco farm—thinks he can crack this system. Ripplewood's portfolio mirrors Japan's decline. It holds Niles Parts, a supplier Nissan Motor dumped; Nippon Columbia, a record company and audio-equipment maker; and Seagaia, a bankrupt seaside resort. The jewel in this battered crown: Shinsei Bank Ltd., the once-mighty Long Term Credit Bank of Japan Ltd., which collapsed in a heap of debt.

As a result of their high-profile bids, the 45-year-old Collins is now one of the most closely watched foreigners in Tokyo. "I think the sale of LTCB to foreigners and Ripplewood was probably the best step Japan has taken to reform its markets," says Jack R. Rodman, managing director of Ernst &



Young in Japan. Yet even Collins' own team sounds doubtful times. "I certainly have the impression they're optimistic about Japan," says Paul A. Volcker, the ex-chairman of the Federal Reserve who is an adviser to Shinsei. "For the sake of the world, I hope they're right."

Collins has already gotten plenty of grief for his faith in Japan. Since Ripplewood's bid for Shinsei, xenophobic campaigns have targeted Collins' shop. Putin and former McKinsey & Co. partner Kenichi Ohmae rallied against the idea of foreigners taking over LTCB. Last year, Shinsei refused to forgive loans to retailer Sogo Corp. Instead, it exercised

RIPPLEWOOD'S WORLD

U.S. AND EUROPE

1996 Ripplewood Partners LP. Invested \$430 million in two dozen companies, from construction materials to frozen pies to educational publishing. Recently sold Edwards Baking and ICM Equipment Sales & Rental for three to five times cost.

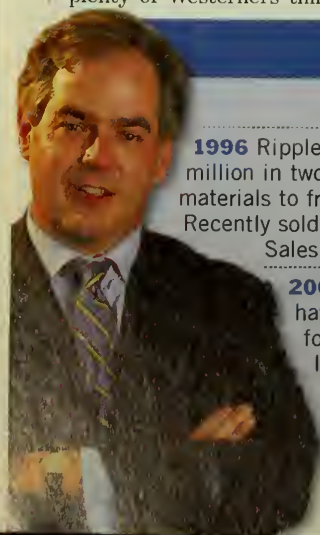
2001 Ripplewood Partners LP 2. Will have \$1 billion under management soon for fresh deals in the U.S. and Europe. Investments include the polymers business of Royal Dutch/Shell Group.

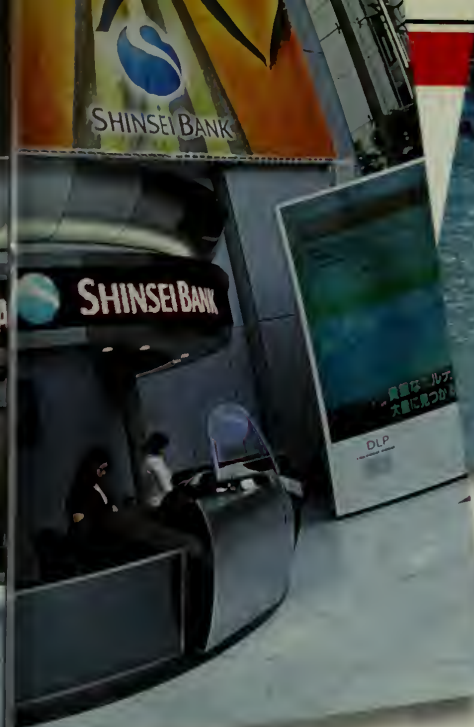
TIM COLLINS OF RIPPLEWOOD

JAPAN

1999 Long Term Credit Bank of Japan, now called Shinsei Bank of Japan. Ripplewood purchased it for \$1.2 billion and revamped information-technology system and branch network. The bank earned \$730 million in fiscal 2000, but it is still saddled with problem loans worth billions. It is expected to go public by 2005.

2000 RHJ Japan Fund. Has raised \$1.2 billion. Bought Niles Parts, recording house Nippon Columbia, and the bankrupt resort Seagaia, which cost \$2.3 billion to build, for \$150 million in all.





Diverse Empire

Ripplewood's holdings include Shinsei, the Sea-gaia resort, and recording house Nippon Columbia

an escape
ause Collins had
rung out of Tokyo
d handed the bad
an to the govern-
ent, forcing Sogo
to bankruptcy. That
ade headlines for
eeks. Since then offi-
als have balked at
king back other
ans and rapped
insei for not giving
ough loans to small
usiness. In riposte,
insei CEO Masamoto
ishiro told Parlia-
ent that authorities misled them about
e bank's loan portfolio.

The odd thing about Collins' Japan-
e high-wire act is that his U.S. in-
struments are so humdrum: frozen-pie
mpanies, industrial-equipment lessors,
to dealerships. Ripplewood Partners
, the fund he started in 1996, has
rned these ventures around, cashing
t of some at more than triple their
st. "If private equity firms can get
ice their money back in the current
vironment, it is a huge achievement,"
ys Phil Shaw, a managing director at
vesco Private Capital, which is a Rip-
wood investor.

For all Collins' deal-making acumen, he
most checked out of the investment
me long ago. A philosophy major with
keen interest in spiritual matters,
llins spent a month at a refugee camp
Sudan in 1988 sorting out his priorities.



Collins sought the ad-
vice of a mentor, Texas
financier Richard Rain-
water, who told him,
Collins recalls: "God
didn't make you a poet,
or a six-foot-eleven cen-
ter. But you are pretty
good at doing this."

Collins stuck with
business. He ran the
New York office of
Toronto-based invest-
ment company Onex
Corp., then founded
Ripplewood. He may
spend up to three
years researching an
industry or company before making a
move. "There is a sort of cowardice in
what I do," says Collins. "I am really
risk-averse."

Yet has he correctly sized up the risks
in Japan? "I objected to his idea of com-
ing to Japan," says Mitsubishi Corp.
Chairman Minoru Makiyama, who sits on
Ripplewood's board. But Collins con-
vinced his directors the deals were ir-
resistible. LTCB, with \$81 billion in assets,
cost \$9.4 million, plus a promise to invest
\$1.13 billion more. The government also
took \$37 billion in bad loans off its books.
Collins figured if he could get his hands
on LTCB, he could provide banking ser-
vices—plus merger, restructuring, and
investment advice—to Japan's corporate
elite. He recruited Yashiro, the retired
boss of Citibank Japan, to run the show.
The team then persuaded Citigroup, Mel-
lon Bank, and GE Capital to chip in.

After
running losses for the
three previous years, the bank turned a
\$730 million profit for the fiscal year end-
ed Mar. 31, 2001, mostly from cost-cut-
ting. On Nov. 12, Shinsei estimated earn-
ings for the fiscal half-year ended Sept.
30 at \$270 million. The strategy is now to
transform Shinsei from a low-profit in-
dustrial lender into a top-flight retail and
commercial bank. Yashiro also hired a
top info-tech whiz, Dhananjaya Dvivedi,
from his old haunt, Citibank Japan. The
old IT system was so poor, says Yashiro,
"the bank didn't have a monthly profit-
and-loss statement."

The worsening environment and sour-
ing relations with the government may
hinder the bank's recovery. Shinsei claims
55% of the loans classified as questionable
when it took over the bank are nonper-
forming. And it's not clear the govern-
ment will honor its promise to buy back
loans that drop by 20% or more in value
through March, 2003. A big Shinsei bor-
rower, consumer-finance specialist Life
Co., has revealed it has a negative net
worth of \$1 billion. Yet the government
is resisting taking over the debt.

"KILLER" EXECs. Partly because of its
political sensitivity, Collins has walled
off Shinsei from his other Japanese
deals. Financed out of a \$1.2 billion
Japan fund, they are what he terms
"basic businesses." As with Shinsei,
Collins didn't invest until he had lined
up "killer executives" to run them.

Take Japan's Niles Parts Co. The
company is still run by the founding
Suzuki family. But Richard M. Donnelly,
the former head of General Motors Eu-
rope—who also runs Ripplewood's ex-
tensive U.S. auto parts investments—
guides its strategy from the board.
Donnelly's plan is to make Niles the
nucleus of a global auto parts company.

Another rescue job is Nippon Colum-
bia. It has "a wonderful underleveraged

jazz catalogue," Collins says. And Denon, the audio equipment division, "has the potential to be the premier high-end consumer-electronics brand in the world." The plan is to split the studio from Denon and run them separately.

Ripplewood also has a vision for Seagaia, with its 1,300 hotel rooms, five-plus golf courses, and huge indoor beach. Michael F. Glennie, who managed leisure properties for Miami-based Boca Resorts Inc., is the new CEO. Seagaia lost money every year after its 1993 opening, Glennie points out, most-

ly because it awarded big supply contracts without competitive bidding, while its reservations system never adjusted pricing to match demand. Ripplewood is talking to Marriott International Inc. and Starwood Hotels & Resorts Worldwide Inc. about managing the property.

It will take thousands of executives as motivated as Donnelly and Glennie to pull Japan out of its mess. Meanwhile, foreign acquisitions are down 57% year-to-date compared with the same period in 2000, according to Thomson Financial. Collins isn't fazed: "Investing here is

maybe more important than doing it somewhere else," he says. By that standard, if Collins wins, Japan does too. If not, Ripplewood may join a list of foreigners who thought they saw something that wasn't really there.

By Brian Bremner in Tokyo, with Julia Lichtblau in New York

BusinessWeek online

For more on Tim Collins and how he manages his Japanese holdings, go to the Dec 10 issue online at www.businessweek.com.

JAPAN

SHOW TIME AT SOFTBANK

It's still betting on the Net—but where are the profits?

Spend a few minutes with Masayoshi Son these days, and odds are he will sit you in front of his computer and give you a demo of Yahoo! BB, his new Japanese high-speed Internet access service. First comes a crisp, smooth video news clip of Osama bin Laden firing his Kalashnikov, followed by a performance from the local rock group Glay. "This is the fastest broadband access anywhere," Son says, smiling. "We have a mad scientist engineer who did this."

The president and CEO of Tokyo-based Softbank Corp., the globally ambitious Internet venture fund, is counting on Yahoo BB to be the smash hit that will turn around the fortunes of his struggling company. The service has already signed up 200,000 subscribers and is angling for 1.5 million more. Moreover, Yahoo BB is not merely a new add-on to Softbank's 51%-owned Yahoo Japan, the offshoot of megaportal Yahoo. It could allow Softbank to migrate all its Japanese affiliates—including online broker E*Trade Group and an assortment of e-commerce retailers—to a more profitable broadband track.

TOUGH CHOICES. Certainly, Son needs to counter all the bad news about Softbank of late. A sprawling operation with about \$3.6 billion in revenues and a patchy profit record, Softbank has invested in 600-odd Internet and wireless outfits and made a killing by getting in early on Yahoo, E*Trade, and other ventures. By the end of 1999, when Softbank's unrealized gains from its Net stock portfolio hit about \$15 billion, Son was hailed as a visionary.

But the cratering of global high-tech stock prices has diminished Son's aura. In late November, Softbank reported a half-year net loss of \$448 million, due mostly to mark-downs of its Internet portfolio. Softbank's market capitalization has plunged to about \$27 billion, from roughly \$200 billion back in 1999. Two of the

THE BOSS

Son is counting on broadband to turn things around



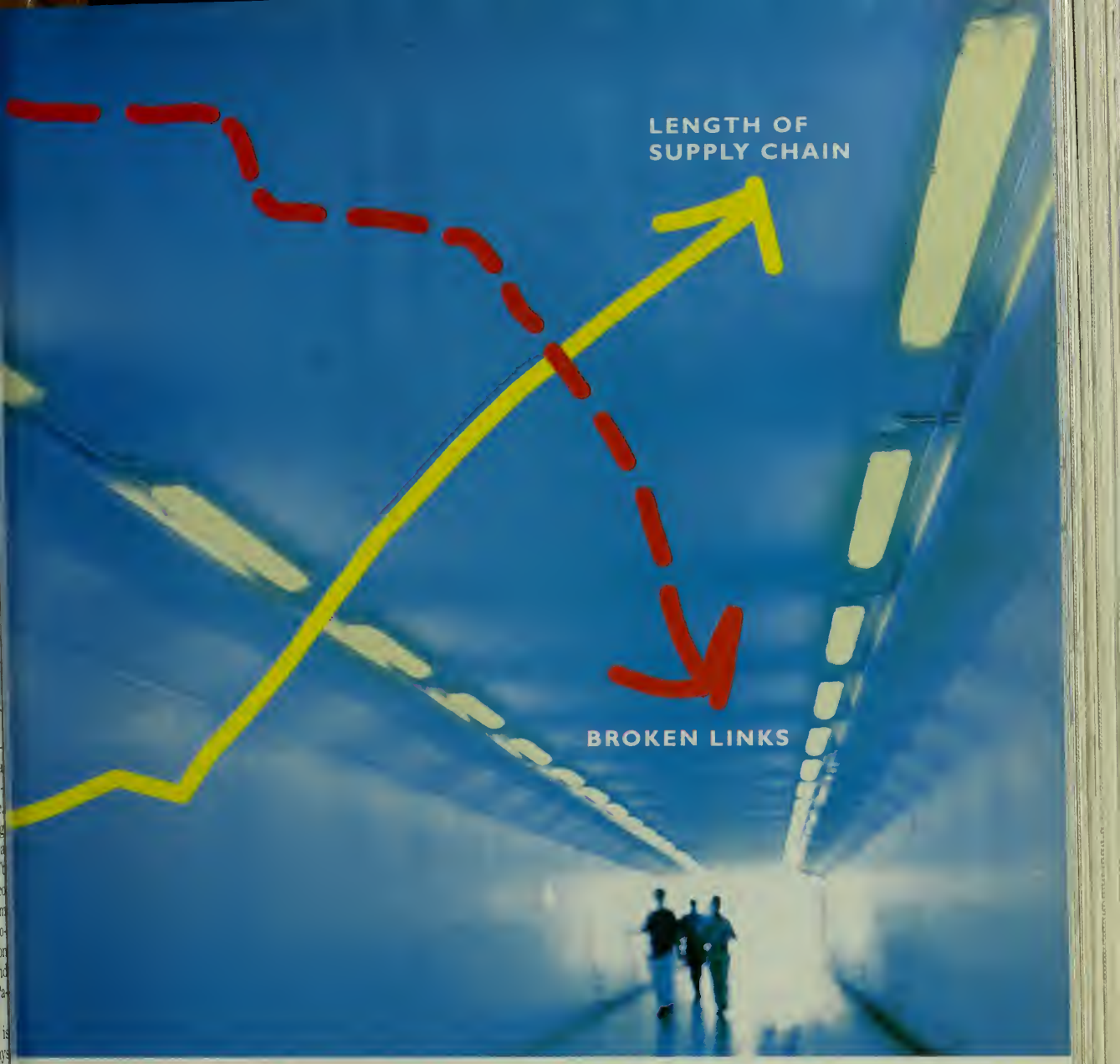
most unfortunate choices: online retailer Buy.com Inc., which struggles on, and grocery delivery service Webvan Group Inc., which went bust. Says Gary E. Rieschel, president of Softbank Venture Capital in Mountain View, Calif.: "We have actively worked to shut down investments that we can't see a future in. There may also be a bomb hidden deep inside Softbank: the \$800 million or so it has invested in unlisted startups, primarily in the U.S. But Rieschel says some of these companies, including e-business software maker Comergen Technologies Inc., are expected to break even next year.

Son knows it's show time on the profits front. He has already shuttered money-losing online Japanese bond-trading venture with Lehman Brothers Inc. and pledges to be ruthless in cleaning out the rest of his stable. "We're doing a lot of pruning," he says. Still, Son hasn't lost his taste for risk. Softbank and Cisc Systems Inc., the U.S. telecom networking giant, have together raised \$1 billion to chase broadband ventures in the Pacific Rim.

Meanwhile, Son is putting in 19-hour days getting Yahoo BB on track. Softbank has offered free installation to early subscribers and charges a bargain monthly fee of \$18. Son thinks his stable of e-commerce units will see a jump in sales by cross-promoting on a souped-up Yahoo that already reaches 20 million Japanese Web surfers.

Son still argues that the Internet will change everything. That may be true, but he has to start making money on the technologies he has already backed. Otherwise, the Net revolution may move on to its next phase without him.

By Brian Bremner in Tokyo



LENGTH OF
SUPPLY CHAIN

BROKEN LINKS

RETURN ON COMMUNICATIONS

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GERMANY

TWILIGHT FOR A TITAN?

Deutsche Bank CEO Rolf Breuer may exit early

As the dark days of a Frankfurt winter rolled in, Rolf E. Breuer was looking forward to spring. The 63-year-old chief executive of Deutsche Bank was set for a graceful May exit to cap his 17-year stint on the management board of Germany's largest bank. Now he is under pressure from key outside investors and board members to make a humiliating early exit in favor of Josef Ackermann, his designated successor. "He's a lame duck who should go now," says a London-based executive in the investment banking division.

While Breuer is unlikely to be forced out, he may conclude his effectiveness has been so eroded by controversy that he has to leave early. On Nov. 17, sources say, frustrated managers openly criticized Breuer at a meeting of the bank's top 40 executives. In a series of blunt exchanges, they castigated Breuer for not laying down a clear enough strategy. Frankfurt has been awash with rumors ever since that Breuer will step down. One issue that may give him a

push: a possible merger with British Bank Lloyds TSB was derailed earlier this year because of Breuer's insistence that the combined company be based in Frankfurt rather than in London. Sources in London say Lloyds is interested in reopening the talks, but not until Breuer is gone.

No one denies Breuer has tucked some big achievements under his belt since taking office in 1997. Once the epitome of the inward-looking German bank, Deutsche Bank now has \$845 billion in assets and is listed on the New York Stock Exchange. Analysts give Breuer high marks for internationalizing the bank by scooping up Bankers Trust Corp. in 1999 and asset manager Zurich Scudder Investments Inc. this year.

Yet the open criticism of Breuer shows how low his stock has fallen. Ackermann, who heads the investment banking division, is considered more in tune with senior managers in the bank and better placed to tackle such problems as the tension between conservatives and modernizers on the board,

UNDER PRESSURE

Breuer calls talk of his imminent departure "absolute nonsense"

says the London-based executive

Probably what has hurt Breuer most is the embarrassing failure of his boldest strategic moves, most notably last year's attempt to merge with arch-rival Dresdner Bank. Breuer tried to sell the combination as a "merger of equals," even though Dresdner had only two-thirds of Deutsche's assets. Deutsche's investors, bankers, who were earning most of the bank's profits at the time, demanded that he restructure the deal as a takeover. Dresdner's board refused to go along.

A few months later, Breuer's plan to sell part of Deutsche's retail banking network to Munich insurer Allianz also fell apart, triggering new eruptions of discontent. In what was widely interpreted as a public slap in the face, the supervisory board named Breuer's successor—months before his retirement date. More recently, critics have charged that the bank's costs are too high and that the asset management division—which reports directly to Breuer—has not been performing well. "Breuer has his successes but his track record is definitely checked," says Jennifer Guest-Cagirtci, head of European equities at London investment manager Gerrard Ltd.

STOCK SHOCK. One result of the turmoil has been that Deutsche's share price has tumbled—important to the bank in London and New York executives, who are paid partly in stock. Shares plunged from \$92.6 in January to \$41.9 in September before recovering somewhat.

Breuer insisted to reporters Nov. 23 that suggestions he was under pressure to quit were "absolute nonsense." For his part, Ackermann protests his loyalty. But he is increasingly taking center stage. He recently

said that when he takes over, he will shake up the board and try to give the chief executive—whom he is treated only as first among equals under German corporate law—greater authority. That would allow him to shake the institution to his bones—and keep the bankers at bay. Watching Breuer's travails, it is clear he knows he has to do better to be successful.

By David Fairclough
Frankfurt, with Stuart Reed in London

Breuer's Report Card

SUCCESSES

- ▶ Acquired Bankers Trust, June, 1999
- ▶ Turned sleepy German bank into global investment bank and asset management company
- ▶ Bought Zurich Scudder Investments in September, 2001
- ▶ Listed on the NYSE October, 2001

FAILURES

- ▶ Merger with Dresdner Bank collapsed in April, 2000
- ▶ Poor cost control eroded profits despite growing revenues
- ▶ Couldn't reconcile conservatives and modernizers on the bank board
- ▶ Share price underperformed competitors

Data: BusinessWeek

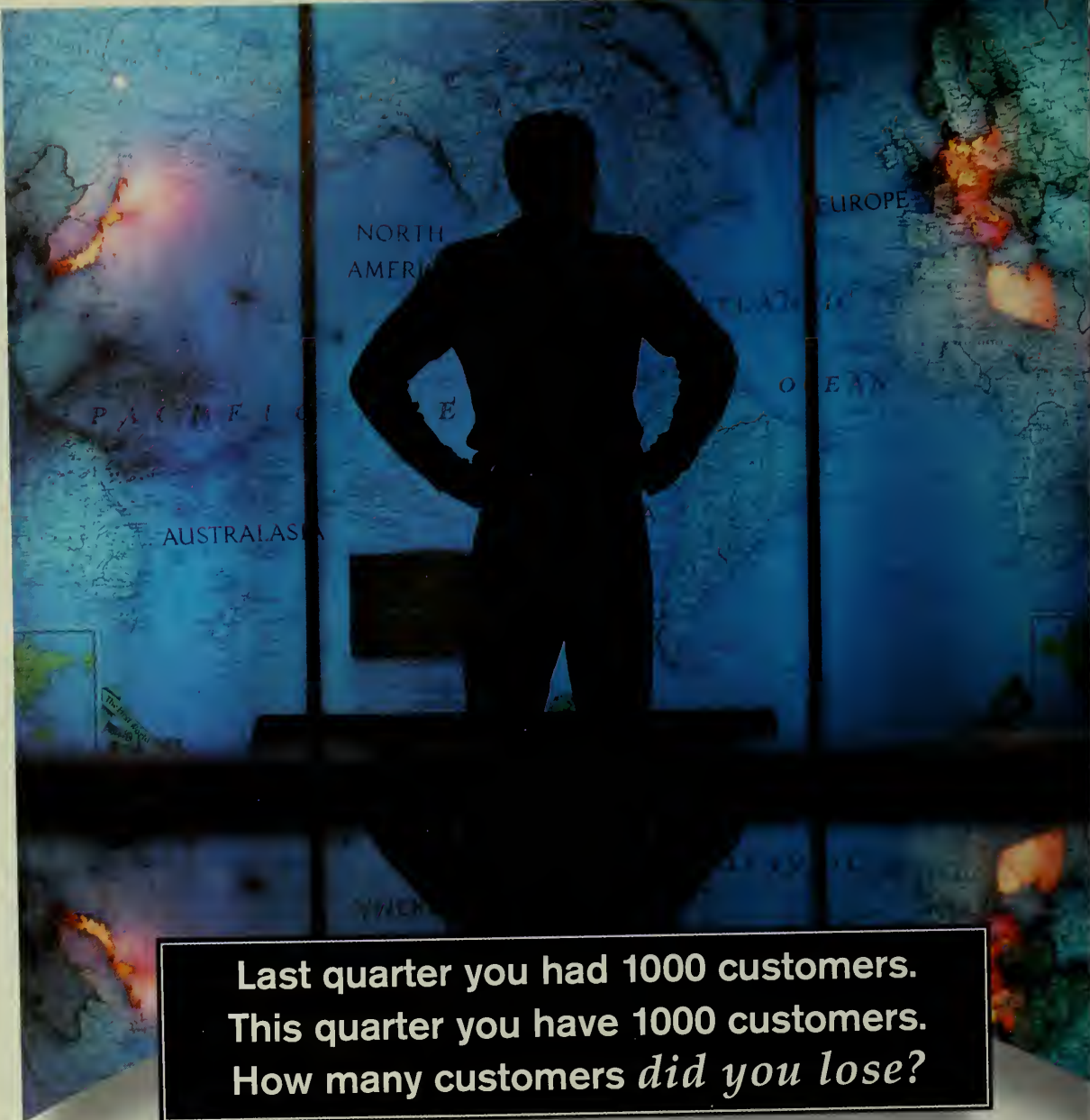
he only downside:

You can't stare at it and drive it at the same time.

Lincoln LS | In March 2001, *Car and Driver* called it "The best-driving V8 sedan for enthusiast dollar." And no wonder. There's 252 horsepower. Near 50/50 weight distribution. And a timeless beauty that will stop the traffic you're accelerating past. For more information or to schedule a test drive, visit Lincoln.com or call 800 688-8898.



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EDITED BY CRISTINA LINDBLAD

MEXICO: THE FOX REVOLUTION IS SPINNING ITS WHEELS

When Vicente Fox swept into Mexico's presidential palace last December, after dislodging the long-ruling Institutional Revolutionary Party (PRI), he had a old plan: He would wipe out government corruption and waste. He would forge a new relationship with the U.S., winning legal residency for millions of undocumented Mexicans laboring there. Perhaps most important, he would undertake an ambitious tax reform and so reap the revenues needed to deliver the improved schools, infrastructure, and social services that Mexicans have long craved.

After nearly a year, Fox's revolution has run smack into reality. The U.S. slowdown has clobbered Mexico's export-powered economy and erased 500,000 jobs, making a mockery of his pledge to create 1.3 million jobs a year. September 11 dampened American support for immigration reform. Cops are still taking down motorists for bribes. And Fox has been fighting a 10-month battle to push tax reform through the opposition-dominated Congress. Legislators of all stripes are loath to back a bill that slaps a 1% value-added tax on food and medicine when nearly half of Mexicans live in poverty. "People still want to give the benefit of the doubt to the President, but his political capital is deteriorating quickly," says PRI Congress member Carlos Ramírez.

TO LATE? The tax legislation may yet be approved, by a slim margin. But it will probably be a watered-down version that will generate too little revenue to fund Fox's ambitious social programs or give his presidency renewed momentum. Meanwhile, faced with plunging prices for oil, the source of one-third of state funds, the administration has had to draw on one of the most austere budgets in years. Analysts regard tax reform as the litmus test for Fox's energy agenda. If legislators are balking at hiking taxes, they are

just as reluctant to heed Fox's call to open the state-run energy sector to private investment. The country needs to plow more than \$50 billion into its power grid over the next seven years to meet soaring demand. Fox wants to let private companies foot part of the bill for electricity and natural-gas development. But foreign involvement in energy is a hot-button issue in nationalistic Mexico.

Fox, who once ran Coca-Cola's Mexican operation, has done little to market either the tax or the energy initiatives. Having carefully cultivated his image as a political outsider, he has been dismissive of legislators—even those of his own National Action

Party. Instead of inviting members of Congress to the palace for friendly one-on-ones, he has delegated lobbying to one of his ministers, Santiago Creel, a crisp lawyer with presidential ambitions of his own. "The relationship between the executive and legislative branches is even worse than it was under PRI rule," says Rosario Tapia, a congressional member of the Party of the Democratic Revolution.

Perhaps most worrisome is the impression that Fox, seeing how difficult bold change is in the new democratic Mexico, may be content just to stay the course. If he's lucky, the U.S. economy will recover by the middle of 2002, giving Mexico a boost. And while his approval rating has fallen, it's still a healthy 70%. That may not last, though. "Fox didn't campaign on doing just a little bit better than the PRI. When people voted for him, they expected grandiose things," says Denise Dresser, a political scientist at the Autonomous Technological Institute in Mexico City. For that to happen, Fox the revolutionary needs to become Fox the negotiator. Otherwise, his next five years in office may prove as frustrating as his first.

By Geri Smith in Mexico City



STYMIED: The downturn didn't help

GLOBAL WRAPUP

BRITONS BRACE FOR TAX HIKES

Prime Minister Tony Blair is losing sleep over the fear of raising taxes. Blair's aides, including Chancellor of the Exchequer Gordon Brown, are hinting that big tax increases will be needed in the next few years to shore up the sagging National Health Service and fix up the schools. Just a few years ago, such an admission would have spelled certain electoral death for Blair's Labour Party. But the public mood has changed. Britons are clamoring for better services. Labour, which has

ruled out privatizing the NHS, is gambling that it will be able to persuade the middle classes to foot the bill for the improvements. For instance, the government wants to ramp up health-care spending from the current 7% of gross domestic product to the European average of 9%.

NO WINNER IN TAIWAN POLL

► None of Taiwan's major political parties is expected to secure a majority in legislative elections scheduled for Sunday, Dec. 2. That's bad news for President Chen Shui-bian, whose 17-month

administration has had to contend with legislative paralysis in the face of Taiwan's worst-ever recession and record unemployment. The Nationalist Party, whose 55-year monopoly on power ended last year, will probably remain the largest party in parliament, dashing Chen's hopes of cobbling together a coalition encompassing his Democratic Progressive Party and smaller opposition forces. While the economy has lately shown some bright spots, continuing political deadlock could further hamper needed economic and financial reforms.

THE SAFETY NET

WELFARE REFORM'S TOUGHEST TEST

Danger ahead as jobs evaporate and public funds get scarce

Lou Ann Cataneo struggled with drugs, abusive boyfriends, and intermittent homelessness before she signed up for job training and counseling services that became available under the 1996 welfare-reform bill. "Welfare reform changed my life," the 41-year-old told a Brookings Institution seminar in Washington last summer, recounting her journey from single mother on the dole to concierge at the New York Marriott Financial Center hotel.

A little over a month later, however, Cataneo's life was turned upside down when attacks on the World Trade Center damaged the Marriott, robbing her of her job and independence. Supporting herself with unemployment insurance and a temporary stipend from Marriott, Cataneo is determined to reclaim her old position or land another job. "I think I'll find something," she says.

Unfortunately, Cataneo is hardly alone. Approximately 60% of the women who

left welfare over the past five years secured jobs. But since September 11, unemployment has been rising at the fastest pace in 20 years. Particularly hard-hit is the service sector, which employed 43% of the former welfare recipients who found work, according to the Urban Institute, a nonpartisan social research group. As a result, many women who got off public assistance are losing their paychecks. To make matters worse, state money for social programs is drying up, services to prepare the unemployed for the workplace are being phased out, and tighter budgets in Washington could reduce welfare block grants to the states.

SECOND THOUGHTS. When welfare reform was instituted in the late '90s, states offered such services as child care, transportation, and job training to help single mothers land work. Now, with state revenues falling, legislators are looking to slash social-service budgets—in some cases by more than half.

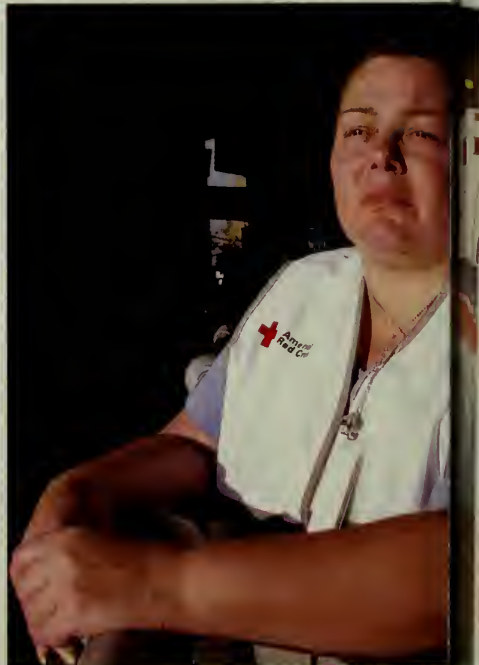
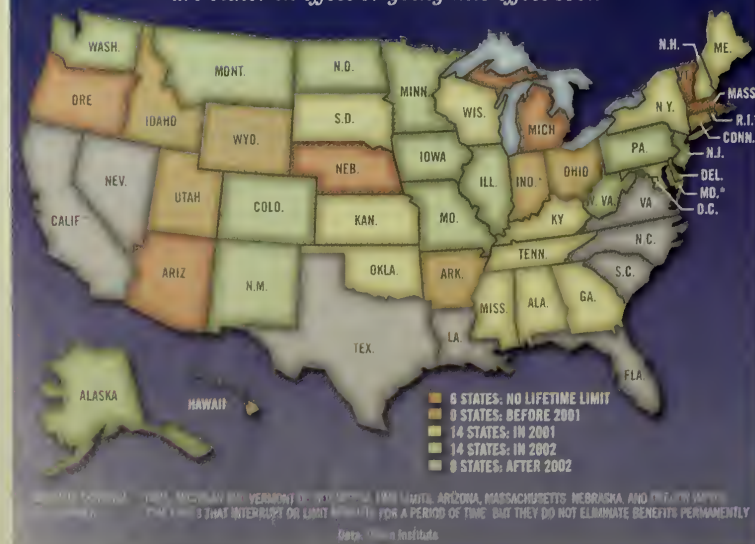
Some states had been maintaining rainy-day funds to see themselves through a downturn. But when Representative Nancy L. Johnson (R-Conn.) warned governors last year that some of her colleagues were itching to reclaim unused welfare money, states quickly spent their stipends. Ohio, for example, had salted away 10% of its welfare block grant before officials became concerned that their nest egg would be seized. "There was a spend-or-lose mentality in Washington," says Joel Potts, administrator of Ohio's welfare program. "What we were doing was exactly the right thing. Now we find ourselves in a situation we tried to avoid."

In addition to laying off social workers and cutting back programs for the working poor, more local government will probably start using some of the federal block grants to pay for social services that they previously bankrolled themselves. Under the terms of the 1996 law, states can use their federal funds for programs like Head Start job-counseling services. In the past, states that took advantage of that option have used savings for priorities like tax cuts or paving roads. Now, with revenues dwindling, the savings will likely go to balancing budgets.

And those block grants could get smaller. With Washington back to deficit spending and focused on funding anti-terrorism efforts, there could be firings next year when Congress decides how much money to send the states for

TIME IS RUNNING OUT FOR THOSE ON ASSISTANCE

In most states, lifetime limits for families receiving welfare are either in effect or going into effect soon



social programs. Liberals want spending to at least remain at 1996 levels: They point out that because welfare block grants are not adjusted for inflation, they have declined 14% in real terms over the past five years. However, Representative Wally Herger (R-Calif.), chairman of the House subcommittee on human resources, said in September that "the world changed" after the attacks and hinted that states will have to make do without additional money from Washington. In addition, supplemental grants and contingency funds for states that spend down their stipend were not renewed when they expired on Oct. 1.

EXTEND THE LIMIT? Funding isn't the only political donnybrook in the offing when the renewal of welfare reform is debated next year. The 1996 bill placed a five-year time limit on collecting federal welfare benefits, and many states imposed even stricter limits. In some states, people on public assistance will be kicked off just as jobs are becoming scarce. Groups like the National Campaign for Jobs & Income Support want time limits suspended in states with high unemployment. They also want the clock stopped for welfare recipients who are in job-training programs or are working but still receiving income supplements.

The picture isn't entirely bleak, though. Now that newly unemployed welfare recipients have work experience, their résumés will make it easier to find jobs. In addition, about 40% of ex-recipients have been working long enough to qualify for unemployment insurance if they are laid off, according to economist Barry Holzer of Georgetown University.

NO GOING BACK: After September 11, Cataneo volunteered for the Red Cross

Before welfare reform, the figure would have been around 15%. And because unemployment benefits are more generous than welfare, those who lose their jobs will be better off, at least in the short term, than if they had stayed on the dole.

The advantages of work are not only measured in economic terms, though. Drawing a paycheck fundamentally changed the outlook of many ex-welfare recipients, and the majority are loath to collect assistance again. "There is no going back," says Cataneo, the self-proclaimed welfare-to-work poster girl. But without government support, there may be no going forward either.

By Alexandra Starr
in Washington

Social Issues



FROM STARTUP TO COMPUTER SCIENCE: Bernhardt (right) and student

EDUCATION

GOING TO THE HEAD OF THE CLASS

Workers from battered industries turn to teaching

After getting laid off in March from his job as a marketing executive at Blue Martini Software Inc., a faltering Silicon Valley startup, Patrick D. Bernhardt seized the chance to switch into a field he always had wanted to try: teaching. Within a month, he landed a job teaching computer science at John Muir Middle School in San Jose, Calif. Bernhardt is pleased with the move, despite a 50% drop in salary and a summer training stint. He must also go to evening classes three times a week for the next two years to qualify for a teaching license. "This is the hardest thing I've ever done, but the sense of satisfaction is great," he says.

The 24-year-old Stanford University graduate is one of thousands around the country who are turning to teaching as the recession tosses more people into the job market. The trend is especially pronounced in such high-tech hot spots as Silicon Valley, where the slump started earlier and typically affects more college-educated workers, who can qualify

to be teachers. "We've benefited from the downturn," says Toni Patterson, assistant superintendent of staffing at Wake County school district in North Carolina's Research Triangle. "Even spouses who had left teaching are coming back after their significant others have been laid off." A rush of applicants has slashed the county's vacant teaching posts to 38, down from 100 last year.

A BOON. Indeed, the economic woes of Corporate America are proving, at least temporarily, to be a boon for education, which has been plagued by teacher shortages for years. Nationwide, the teaching labor force expanded by 2.8% in the 12 months ending in October, even as the recession drove down the national labor force by 0.7%, says Ron Bird, chief economist at the Employment Policy Foundation in Washington. That jump is helping schools enjoy an expanded pool of qualified workers after years of struggling to compete with higher-paying jobs in technology and other sectors.

The newfound interest in teaching



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Social Issues

may not be enough to end the chronic shortfall of educators, however. The U.S. still must hire more than 2 million new teachers in the coming decade to replace aging baby boomers and to handle an upsurge in immigrant children, according to a 1999 study by the Education Dept. The projections were made before the new applicant boom, but it's likely there will be a steady stream of new teachers over such a long time period, experts say.

In fact, education experts fear worse: Once the economy turns around, all these people are going to bail," frets

Carlos Ponce, chief human-resources officer for the Chicago public school system. Experience suggests he may be right: Studies show that turnover can reach up to 60% among those who make a mid-career switch to teaching. If too many new applicants bolt for the first corporate job that comes along, the resulting turmoil could leave schools worse off, worries David Haselton, president of Recruiting New Teachers, a nonprofit outfit in Belmont, Mass.

ANNUITY. To hang on with the newcomers, schools need to boost pay. Although most teachers receive good benefits and don't work during the summer, starting teachers earn only about \$28,000 a year and must wait years to reach the average salary of \$42,000.

That's more, teacher salaries have risen just 2.9% a year since 1990, barely more than the rise in consumer living costs. Big pay hikes aren't likely, though, even the recession-induced squeeze on state and local budgets, which pay for the bulk of education expenses. "Because the pay is so low, I've done everything from construction work to custodial work during the summer," says Michael Kerr, a second-grade teacher who earns only \$32,000 a year in pricey New York City.

Credentials present a formidable hurdle for many career-switchers, too. Most states allow those who didn't get their training in education to teach on a temporary basis, but usually they must be

certified within a year or two. Bernhardt, for instance, took several one-day classes last summer, then taught a summer-school course under the guidance of a regular teacher. The evening classes he is taking at a nearby college cover pedagogy and other subjects he needs to be a qualified teacher. New teachers usually have to pay for the extra learning out of their own pockets—\$3,000 in Bernhardt's case.

For the moment, though, schools are also the beneficiaries of a sort of September 11 effect. As people grope for ways to do something meaningful, some

turn to teaching. Bank Street College of Education in New York saw a record turnout at a recent open house for people looking to make a mid-career change. "I'm getting numerous e-mails from people saying they need to rethink their lives and are wondering about teaching," says Jon Snyder, dean of Bank Street's Graduate School of Education.

Some school districts are becoming adept at helping recruits make the transition from other professions. San Jose, for example, has a program that provides coaching and mentors to working adults with BAS who want to become teachers. If they pass a test, the district works with a nearby college to arrange the courses applicants need to get certified. "Becoming a

teacher in California isn't easy; there are millions of forms to fill," says Jennifer Long Bauer, a 26-year-old former dot-commer in San Jose who's teaching seventh and eighth grade now. San Jose's Teaching Fellows program "guides you along."

Most economists think the jobless rate will continue to rise next year even if the recession is relatively mild. This creates an opportunity for schools to reach out to people whose first instinct is to go to higher-paying fields. The trick for educators and school districts will be making teaching so rewarding that the newcomers stick around when more lucrative jobs beckon once again.

By Pallavi Gogoi in Chicago

SUDDENLY, TEACHING LOOKS PRETTY GOOD

The recession and tech slump have drawn thousands of college grads into the profession, easing shortages

AUSTIN, TEX. At the city's 107 schools, teaching applications are up 35%.

CHICAGO A severe shortfall of substitutes is over at the city's 600 schools after a 50% increase in the pool of substitutes.

FAIRFAX COUNTY, VA. Applications at the county's 205 schools are up 47% this year.

SAN JOSE, CALIF. No teaching vacancies in the city's 44 schools. Last year, 45 posts went unfilled.

WAKE COUNTY, N.C. Vacancies dropped to 38, down from 100 in 2000.

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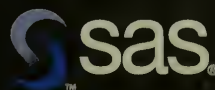
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THE RESOURCE FOR ENTREPRENEURS

DECEMBER 10, 2001

Forecast 2002

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savings on his
struggling company



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BusinessWeek Small Biz

12/10/2001

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Cover Story Forecast: Cloudy

What's next for small business? Your guess would be as good as ours, if you had rounded up the top gurus in every branch of small business and asked what to expect in 2002. That's what we did, and we learned that there's good reason for gloom and doom—along with plenty of opportunities. Here's where to look for the silver linings, and how to make sure they wind up in your pocket



IT'S A SIGN: Where entrepreneurs are focusing now (page 4)

Great Voice's Berkley will spend more on marketing and go to more trade shows (page 16)



IN BOX

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If your phone is just a phone, you need a new phone system

14 Life & Co.

Small businesses in the heartland are "adopting" their stricken kin around Ground Zero in New York

UNDER 30

22 Vikram Agrawal's

global-minded transcription service is never at a loss for words

SMALL BIZ
FAREWELL

Forecasting is always an inexact science, but here's one prediction you can take to the bank: *Small Biz* won't be around next year. The five-year old supplement is a victim, alas, of the weak economy. We hope your business continues to thrive and that we have played a role in helping you achieve your goals. *BusinessWeek* will continue to cover entrepreneurs and small-business issues in its regular pages and at BusinessWeek Online.

—The Editors

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Homeland Defense

ENTREPRENEURS ARE LOOKING OUT FOR NO. 1

ME FIRST: SMALL-BUSINESS OWNERS are more focused on personal finances and less concerned about expanding their businesses than they were before September 11. Just 17% of entrepreneurs now say business growth is an extremely important goal, compared with 26% who said so before the terror attacks, says a survey by NFO WorldGroup. Two of the top financial **PRIORITIES HAVE SHIFTED FROM GROWTH** and building an investment portfolio to maintaining standards of living and financing children's education. "It's a sharp reaction," says Maria Erikson, executive vice-president at NFO WorldGroup's Tampa office. "There's more focus on short-term goals." But no one expects this to last. When the economy bounces back, Erikson says, expect a **RETURN TO BUSINESS AS USUAL**—which for entrepreneurs means a focus on business.

SO THEY SAY

"It's pure blood coming out of my veins."

Shakir Khan, owner of InnSecure Inc., a network security company in Hayward, Calif., on his struggle to keep his business afloat (page SB16)

ONE IOTA

OFF THE HOOK

Percentage of entrepreneurs who say switching to DSL improved productivity

Data: The Yankee Group, SBC Communications

76

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Tired of hunting for credit information on new customers? QuickBooks Pro's 2002 version will give you direct access to credit reports from Dun & Bradstreet for \$10 a report. Another bonus: The new release will also integrate with other applications, so you won't have to transfer data manually if you use a variety of programs.





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William B. Gartner,
USC professor of
entrepreneurship, on
**STARTING A NEW
BUSINESS**

Will we see much start-up activity in this down economy?

New business formation will continue because the average amount invested in a new company is \$5,000, and that's pocket change for many. Also, in an economy based on information rather than manufacturing, organizations are becoming smaller and more numerous.

What causes people to start businesses in these times?

A lot of people will go into entrepreneurship because of layoffs. And then there's tons of opportunities for smaller companies because in a recession larger ones aren't hungry for business.

What are the key issues that an entrepreneur will have to face in this environment?

Fantasies about growth and profitability. The rates of return in the late '90s may not come back. Those rates of 15% to 25% are abnormal. A 3% to 5% secure rate of return will be the norm now. So people's expectations will have to be in line with that reality.

Idea Launcher

NASA LENDS BUSINESS ITS EXPERTISE

NEED HELP DEVELOPING AN IDEA in the areas of biotechnology, communications, or security? The Garrett Morgan Commercialization Initiative at NASA's John H. Glenn Research Center in Cleveland offers small companies access to NASA expertise.

So far, the three-year-old program has helped 50 businesses. The latest: Alpha Port Inc., a six-person engineering outfit in Cleveland. It will use NASA's advice to **DEVELOP WIRELESS INTERNET CAPABILITIES** for remote areas—a technology that owner Rosella Miranda says will have military and commercial applications.

Technology transfer aside, the program is also customized to provide small companies with assistance in management, finance, and marketing.

To apply, your company must be located in the Great Lakes region, have fewer than 500 employees, and be **FINANCIALLY STABLE AND TECHNOLOGICALLY DRIVEN**. If your company fits the bill, NASA could be a nice booster for the business.



CHEERY: Dolphin Control Systems' Michael Camel and Miranda have received NASA help

Right at Home with Telecommuting

IF YOU THINK YOUR SALES STAFF could work just as well from home, you've got plenty of company. More than 86% of small-company executives surveyed by *Sales & Marketing Management* in New York say salespeople who telecommute are at least as productive as office-based workers. "When telecommuting started five years ago, there was a suspicion on the part of managers that people wouldn't be doing their jobs," says Melinda Ligos, editor-in-chief of *Sales & Marketing Management*. "Now, they've realized it's a good option and an advantage in recruiting workers." About 46% of small companies allow telecommuting, but it's still a good idea to do a three- to six-month test run before establishing any policy.



The Information Mill

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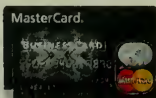
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FRONT

LINE

NEWS
ANALYSIS
IDEAS FOR ENTREPRENEURS

STATS OF THE MONTH

38%

of CEOs of fast-growth companies analyze their cash-flow data every day

12%

of small businesses laid off workers in September

1%

of the nation's GDP in 2000 came from venture-capital investments



PATRICK DUROSEAU:
Moving from the
Twin Towers to
the Beltway

MANAGING

Beltway Bound

SMALL BUSINESS GOES AFTER THE FEDERAL PIE **BY LARRY KANTER**

FOR FOUR MONTHS, it was the perfect headquarters. By setting up shop on the 93rd floor of the World Trade Center, Marnic Technologies Inc., a computer-networking startup, had placed itself at the center of the financial uni-

verse. "You couldn't beat the address," says Executive Vice-President Patrick Duroseau.

Now, with the trade center in ashes, Marnic's 10 employees—all of whom survived the September 11 attacks—are crowded into a

temporary space in midtown Manhattan while Duroseau, 29, scouts for a permanent home for his company. He's looking in what he considers the nation's new economic hot spot: Washington, D.C. "If you want to be a serious player," he says, "you have to be in the Beltway."

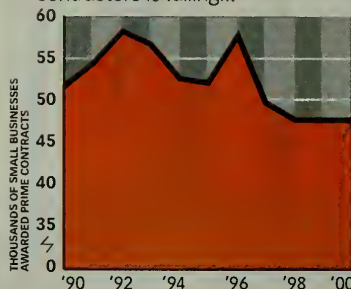
Duroseau's plan is to reinvent himself as a government contractor. Six months from now, he expects 70% of Marnic's revenues to come from public sources, vs. less than 10% now. "The private sector is anemic," he says. "Our focus has shifted."

Such shifts are occurring at small companies nationwide. In the wake of September 11, both consumers and businesses have slashed spending to the bone. But federal expenditures are on the rise. President Bush authorized \$40 billion in emergency spending, and the ongoing war against terrorism is likely to spark more in the months to come—which has not gone unnoticed by struggling small-business owners. At SmallBusinessDepot.com, a Lyndhurst (N.J.) Web site that links would-be vendors with federal contracts, registrations have tripled since September 11, says Executive Vice-President Don Mazzella. "Businesses are smart," says Brian Headd, an economist with the Small Business Administration's Office of Advocacy. "They go where the money is."

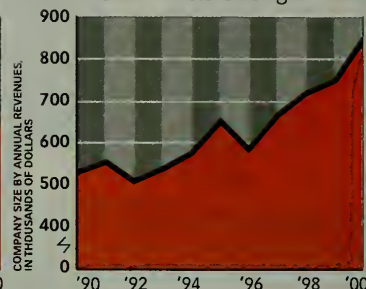
While old customers have turned stingy, Uncle Sam's wallet is open

Whether much of that money goes to entrepreneurs remains to be seen. Congress mandates that federal agencies award 23% of contracts to small businesses. But the feds have yet to meet that goal. In 2000, small companies received just 18.8% of federal contracting dollars, compared with 19% in 1999, according to Eagle Eye Publishers Inc., a Fairfax (Va.) research firm that tracks federal contract data. In fact, the number of small businesses awarded prime contracts

The number of small-business contractors is falling...



...and the average size of companies awarded contracts is rising



fell to its lowest level in more than a decade last year, while the average size of the small-business contractor, and the average size of contracts they've received, have swelled. "It's becoming much more difficult for smaller businesses to enter the market," says Darryl Hairston, who oversees contracting-related programs for the Small Business Administration.

And it's about to get worse, thanks to the urgency that surrounds procurement. The Defense Dept. already has exempted contracts valued at \$200,000 or less from rules designed to promote small-business contracting, in an effort to speed up the process. "The priority is security," says Eagle Eye President Paul Murphy. "Meeting small-business goals becomes a secondary consideration."

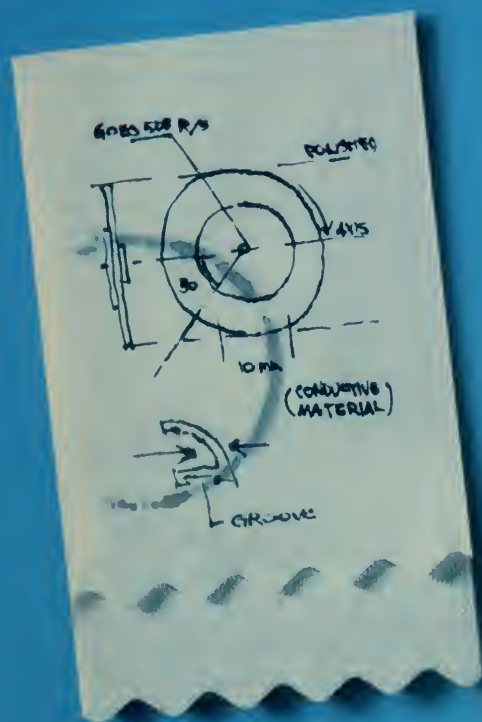
Entrepreneurs aren't deterred.

pany—devoting 90% of his marketing budget to cracking the public-sector market. "Everyone's attention is focused on that space," says Crescenzo. "It's where we think we can get our biggest return on marketing."

Crescenzo could be in for a shock. "The same strategies that work in the private sector don't work in the public sector," says Murphy of Eagle Eye. Established contacts are key, and the paperwork can be overwhelming. Duroseau recently submitted a bid for an \$87 million contract to upgrade computer networks at the Defense Dept. The proposal was more than 100 pages long, and Duroseau was forced to turn to a consultant for help. "It's a nightmare," he says.

On the other hand, in a nation turned upside down by terrorism, some entrepreneurs are in the position of having the government approach them. Consider Stephen Coady, CEO of Apelon Inc., a Ridgefield (Conn.) medical-software company with 6 employees. Apelon's signature product is a program that translates scientific and clinical terms into colloquial English. After September 11, Coady was deluged with calls from federal agencies, including the Centers for Disease Control & Prevention and the National Library of Medicine, seeking his software to help monitor reports of symptoms associated with bioterrorism. "We've been waiting nearly a decade for this kind of enthusiasm," Coady says. Not only is he doing something for his country, his company is doing something for him.

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At first blush, these call centers seem rather mundane; they consist of a standard PC, digital phones with small screens, and software. But the ability of call centers—known as Internet Protocol Private Branch Exchange systems, or IP-PBXs—to automatically route

inquiries means that fewer customers get lost in the shuffle. IP-PBXs can also do clever things like redirect calls to home-office workers without getting the phone company or your IT staff involved.

Mind you, call centers are not omniscient. Their most dazzling feature—a pop-up computer screen window that reveals the name and sales history of each incoming call or e-mail—works only if data were previously entered into the system. Even then, the software must be compatible with whatever contact-management application you have installed.

Also, call centers aren't cheap. A 25-person company can easily pay \$15,000 to \$50,000. Still, that's within reach of many businesses that, until recently, saw call centers available only for \$100,000 or more.

Park Productions Ltd., an ad

RANDOM access



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EYE OPENER

If you need to keep an eye on things back at the office, look at Panasonic's Myeyecam.com subscription service. The \$39.95-a-year service supports Panasonic's KX-HCM10 network camera and takes care of the complicated configuration issues associated with sending live Internet video (www.myeyecam.com).

agency in Orion (Mich.), spent \$15,000 to equip its 25-person office with a new IP-PBX system from Altigen Communications Inc., replacing system bought in 1991. Vice-President Ralph Liebner's favorite feature: reports detailing the amount of time employees spent with given customers. He uses them to bill clients.

Tee's Plus of Groton, Conn., a \$13 million-a-year T-shirt printer, also decided the time was right. It spent \$19,000 in October for a new IP-PBX from 3Com Corp., replacing a 10-year-old phone system that didn't even have voice mail. "We used to lose business because messages weren't passed along," says Thomas V. Craig, director of marketing for Tee's Plus. Among the benefits of the new call center: new wiring. All 69 employees plugged their IP phones right into the company's local area network. True, \$19,000 isn't chump change, but what's the cost of a disconnected customer?

—KEVIN FERGUSON



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LIFE & COMPANY

Small Biz to the Rescue

ENTREPRENEURS REACH OUT TO THEIR OWN AT GROUND ZERO **BY ROBIN D. SCHATZ**

JUST A FEW DAYS AFTER SEPTEMBER 11, Margy Layton was making her annual eight-hour drive from Springville, Utah, to a booksellers' trade show in Denver. Along the way, she kept replaying the tragedy in her mind. Like millions of Americans, she had already attended a candlelight vigil, donated blood, and given money to relief funds. But she also wanted to help another, less obvious group of victims—

the small businesses affected by the Twin Towers' collapse. "One of the things that really struck me was, 'Oh, my word, if I had to start my business from scratch again, would I be able to cope—and what would help me do that?'" says Layton, who owns The Read Leaf bookstore with her husband, Roger.

By the end of the drive, this 38-year-old former marketing executive for Novell had concluded that what she and her fellow entrepreneurs in Springville should do was "adopt" New York businesses affected by the terror attack and provide them with whatever help they need.

September 11 struck the same nerve with entrepreneurs from coast to coast. In San Francisco, insurance agency owner Scott Hauge, is well on his way to raising \$100,000 from area businesses to donate to the World Trade Center Small Business Recovery Fund, established by the New York State Small Business Development Center (www.nyssbdc.org/Recovery/White_Paper.pdf) and a consortium of banks. The fund will initially give out \$5 million worth of low-interest loans of \$50,000 or less to affected entrepreneurs—based on their character, not collateral, says state SBDC Director James L. King. In Chicago, 34-year-old serial entrepreneur Stephen Meade donated his startup's technology for a Web site where companies can register to provide free goods and services to afflicted businesses in New York (www.eams.org). And in the quaint, picture-book towns of Massachusetts'



BOOKSELLER LAYTON:
"Adopting" hurt businesses
in the WTC zone

Berkshire hills, antique dealers organized an auction and tag sales that raised about \$25,000 for the Manhattan Chamber of Commerce's grant program. Inspired by e-mail from Layton and others, the Chamber and city officials are setting up an adopt-a-business Web site.

It's safe to say that there has never been such a national outpouring of support from entrepreneurs to help their own. Indeed, the nation's small businesses have hardly been the picture of unity—or uniformity. "Whenever I've tried to describe the small-business community, I always felt it was a bit like describing a herd of cats," says King of

the New York State SBDC. "Everyone moved in their own mysterious way, and everyone moved in a different direction simultaneously." That has changed since September 11—like just about everything else in our lives.

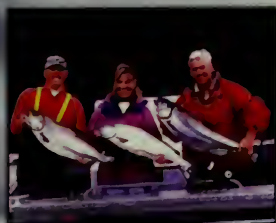
Perhaps it's because most entrepreneurs know deep down that only geography and luck spared their businesses—this time. In the World Trade Center and the surrounding blocks, there were tech-consulting firms and graphic designers, bond traders and law offices, and, yes, fruit stands, luncheonettes, and shoe-repair shops—many of which will never recover. Each embodied someone's entrepreneurial impulse, no matter how modest or grand. "This was a deliberate attempt to ruin our economy," says Emanuel Martinez, a former corporate accountant who now is a managing partner of GreenHills Ventures LLC, a private equity fund in New York for early-stage companies.

Martinez has organized a new group called the Downtown Cooperative Project to help displaced businesses in Lower Manhattan get discounted goods, services, and other assistance. "The best way to get up out of this and [become] stronger as a nation and as Americans is to stand up, step forward, and do whatever we can," says Martinez. If that means a bunch of ornery cats have to move in more or less the same direction for a change, so be it.



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Wh
tech

What's next for small business in finance, technology, labor, the economy, and more
By Naweena A. Mangi

Forecast 2002

SHAKIR KHAN HAS ALWAYS FACED THE FUTURE head-on, methodically setting goals for himself and then meeting them. That discipline helped him build InnSecure Inc. into a \$3 million company in just a year—and to start a second company, Colowatch Inc., last June with a partner. But now when Khan (cover photo) looks ahead to 2002, he's hard-pressed to see exactly where he will end up. It's easy to understand why. Last summer, the technology downturn forced InnSecure, a Hayward (Calif.)-based network-security company, to lay off three people. The four remaining employees were dismissed just after September 11.

Today, Khan, 39, is struggling to reverse the sagging fortunes of Colowatch, an information-technology infrastructure outfit. He had projected sales of \$1.8 million in the first year, but his investors turned skittish after the terrorist attack, and he's still trying to raise the funds he needs to get there. When it comes to the future, he has more questions than answers. Will investors come through? Will he be able to bring in new business? Or will he face personal bankruptcy? "I have borrowed on my house for InnSecure and put all my savings of 15 years into Colowatch," Khan says. "It's pure blood coming out of my veins."

Get out the tourniquet. The forecast for 2002 has no recovery in sight until second quarter at the earliest, and the current climate of war and insecurity makes predictions more speculative than usual. What's certain is that it's a world of diminished expectations, as entrepreneurs downsize their growth projections and their budgets. In a recent PricewaterhouseCoopers survey of fast-growth CEOs, 30% said they expected the U.S. economy would decline over the next 12 months. Before September 11, only 22% felt that way. As for revenue growth, just 11.5% expected increased sales, vs. 17.2% before the attacks. They were equally gloomy about capital spending and hiring for the coming year (table).

Indeed, nothing about the 2002 economy is going to be easy. Tightening credit will make it harder to finance business expansion or bolster your cash flow, and it's a safe bet investors will continue to shy away from anything that's remotely risky. Worse, health-insurance costs will rise dramatically next year, forcing you to make some tough decisions about your workforce and benefits.

But that doesn't mean you should wait passively for an upturn. To the contrary, you'll need to be proactive, continuing to invest in marketing, for example, even as your cash flow tightens and profits sag. And for some entrepreneurs, adversity can create opportunities. This might be the time to grab market share from weaker or disappearing competitors. Rising unemployment means looser labor markets and the chance to hire some highly skilled workers at saner wages. And if you're on the prowl for an acquisition, it's a buyers' market. To help you clear up the uncertainties ahead, we've set out the management challenges you'll face in the coming months and what you can do about them.

Labor & Benefits

UNEMPLOYMENT WILL CLIMB IN THE FIRST QUARTER OF 2002 as corporate layoffs continue. Sadly, that's good news if you want to hire the skilled employees you couldn't get during the boom years. Salaries will be slowing too, with increases for small businesses averaging about 4% in 2002, compared with annual hikes of 7% over the past few years, says Daniel Moynihan, principal of Compensation Resources Inc., a compensation consulting firm in Upper Saddle River, N.J.

But don't get too smug. Even as salary costs moderate, you'll face huge jumps in your health-insurance premiums. Brace yourself for increases next year ranging from 20% to 50%. For some small companies, hikes will be steeper still. Robert Klein, who owns a seven-person labor law practice in Highland Park, Ill., faces a 60% hike for 2002. That's on top of 25% to 35% average annual increases over the past five years. "It's our single largest cost component after salaries," he says. Reluctant to cut benefits, Klein is shopping around for alternatives such as a Medical Savings Account in which employers contribute a fixed amount to employees' accounts. If employees don't spend the money on medical needs, they can pocket the cash. But if costs continue to rise at this pace, he says he'll have to cut staff.

To save on health-care costs, Larry Levitt, vice-president at the Henry J. Kaiser Family Foundation, recommends that small companies form purchasing pools (such as PacAdvantage in California) to increase bargaining power. Or consider using an online broker like ehealthinsurance.com or Quotesmith.com to scout out discounts and get a wider array of choices.

Business Insurance

IN A RISKIER WORLD, EXPECT YOUR INSURANCE BILL TO rise. You'll see premium increases of 15% to 25% next year on most business insurance. That may lead you to consider dropping coverage for 2002, especially if you suffered losses on September 11 and had trouble collecting on your policy. But think twice about going unprotected. "It's always been important," says Bill Wilson, director of the Independent Insurance Agents of America's online research

Diminished Expectations

Fast-growth companies scale back expansion plans over next 12 months

Hiring

Planning to add full-time employees

52% vs. 44%
pre-9/11 post-9/11

Planning Capital Investments

42% vs. 38%
pre-9/11 post-9/11

Data: PricewaterhouseCoopers

and education center. "Now it's critical."

So what are the essentials? Don't go without liability coverage, property insurance, workers compensation, and business interruption insurance, advises Pat Moore, principal of Antalek & Moore Inc., an insurance agency in Beacon, N. Y. "You'll be cutting into the meat if you do," he says. Watch out for terrorism exclusions. They're expected to surface next year in many policies, especially business interruption and property insurance.

Marketing

IT'S TEMPTING DURING A RECESSION TO slash your marketing budget to the bone. Don't give in. This is precisely when you need to woo new customers and strengthen your relationship with existing ones. You could even pick up clients from competitors who aren't being as aggressive. The best time to advertise and market is during the worst of times," says Joe Vitale, a marketing consultant in Austin, Tex., who has worked with small companies over the last two decades. Vitale says companies that persist with marketing in lean times tend to have stronger sales coming out of a recession.

Susan Berkley, CEO of The Great Voice Company, a recording studio in Englewood, N. J., has been holding her own so far. She says her five-person business will have \$750,000 in revenues this year, up 15% from 2000. But she knows her gains could be easily erased in 2002 if she doesn't keep digging away to bring in new business and increase revenues from existing clients. That's why Berkley is boosting her 2002 marketing budget by 15%. "Cutting my marketing budget now would be like writing my own death warrant," she says. She plans to attend more trade shows and produce an e-mail newsletter about voice training to establish her expertise. She's even launching a new voice and presentations skills training program to increase her value to clients.

But if you must cut your marketing, don't cut your own throat. Focus on keeping your existing customers happy, says Al DiGuido, CEO of Bigfoot Interactive, a New York Internet marketing consultancy. Send thank-you notes or e-mails to stay top-of-mind when they resume spending, suggests Vitale. Or, as many small companies are doing these days, partner with competitors that serve the same clients and share customer lists and costs. Anthrax fears aside, you

STRUGGLING:
Khan's investors
got skittish after
September 11

might want to lessen your dependence on direct mail. E-mail marketing is much cheaper. Put your catalog online or try an e-mail newsletter to a carefully targeted list.

Credit Markets

CAN THERE REALLY BE A CREDIT SQUEEZE AFTER 10 RATE reductions by the Fed this year? So it seems. In early 2002, small companies may well have a hard time borrowing. Already, 42% of lenders say the September 11 attacks make them less likely to lend to small companies, says a survey conducted in October by Phoenix Management Services in Philadelphia. And 54% are tightening loan terms, such as collateral requirements and guarantees, on loans of \$1 million to \$5 million, up from 41% in the second quarter. The news from the Federal Reserve is no better: Its quarterly survey released in November found 40% of lenders are tightening credit on small-business loans, up from 32% in August. The irony: Rates have plunged to 8.2%, says the National Federation of Independent Business, down from 10.5% just 12 months ago. "Credit is tighter than at any time in the last 25 years," says Mike Gibbons, partner at



Brown, Gibbons & Lang, an investment banking firm in Cleveland devoted to small and midsize companies. "Interest rates may be coming down, but banks are aggressively ridding themselves of questionable credits and imposing significant restrictions on their customers."

Want to extend your existing line of credit? That will be tough, too. Jerry Valetta, national sales manager for business financial services at Merrill Lynch, says you'll boost your chances if you improve your financial record-keeping and alert your banker to any declines before sending out your financials.

On the plus side, interest rates on credit cards have also come down—and many small-business cards offer rich

rewards. Try tapping into your network of suppliers, who may take a stake in your business to keep you as a customer, suggests Edward Cox, partner at New York law practice Patterson, Belknap Webb & Tyler. Or you can resort to factoring. Although you'll pay 15% to 22% by financing your receivables, vs. 5% to 8% on a bank loan, says Richard Drath, a CPA in Fort Lauderdale, Fla., it's worth exploring if you lack the cash flow to qualify for a bank loan.

Technology

SMALL BUSINESS NEXT YEAR WILL SHELL OUT JUST \$50.6 billion on technology, up only 1.9% from this year, says

Tech Spending 2002

In a year of cautious spending, these products offer more bang for the buck

	Product	Vendor	Category	Price	Comments
	PRO/ WIRELESS 5000 STARTER KIT	Intel (intel.com)	Wireless networking	\$750	Increases data transfer speeds of current wireless LANs fivefold
	MAX 8 VOIP GATEWAY	Net2Phone (net2phone.com)	Internet telephony	\$1,800 plus about \$200 for installation	Reduces long-distance phone costs with Internet telephony
	PCANYWHERE VERSION 10.5	Symantec (symantec.com)	Internet security software	5-user and 10-user packs cost about \$645 and \$1,280, respectively	Improves data security for remote workers
	TREO	Handspring (handspring.com)	Wireless cell-phone/ organizer/ Web browser	\$399 with annual wireless service plan; \$549 without	Compact and versatile; available early first quarter 2002
	SNAP SERVER 2200	Quantum (snapserver.com)	Data storage for networks	\$1,499	Add 160 gigabytes of space anywhere on a LAN in about 10 minutes
	WINBOOK	WinBook (www.winbook.com)	Notebook computer	\$1,499	Good price and features; manufacturer has strong track record

International Data Corp., of Framingham, Mass. That will prompt PC makers to deepen the cuts made this fall on the price of higher-end systems. Because low-end PCs are already priced below \$500, don't expect any reductions there. However, PC makers and retailers are likely to add software and accessories to sweeten deals. Better still, generous financing terms from IBM Corp., Dell Computer Corp., and other PC makers will make buying new computers even more enticing.

That makes a recession a fine time to buy technology—but only if you truly can't do without it. Try focusing on purchases that improve your business' day-to-day efficiency or cut costs (table). Otherwise, try to squeak by with your present equipment. Prices will continue to fall, and those financing deals will still be in place for months to come.

The same cautious approach goes for software purchases. Some upgrades—for example, Symantec Corp.'s pcAnywhere version 10.5, just hitting store shelves now—make good sense. With it, you can improve Internet security for remote workers. Other upgrades—most notably Microsoft Corp.'s Windows XP—offer benefits that are concrete and commendable, but probably not compelling enough to make you spend precious cash.

If not a new server or software, what should you buy? Consider new high-speed wireless local area networks that increase current data-transfer rates nearly fivefold, to 54 megabits per second. They include Intel Corp.'s new Pro/Wireless 5000 LAN Starter Kit. While slightly more expensive than older 11 megabits-per-second wireless networks (\$750, vs. \$600 for a comparable network), your investment in productivity may make up for the extra cost.

Second, consider buying technology that allows you to make long-distance calls over the Internet. The audio quality of the technology, known as Voice over Internet Protocol, or VoIP, still leaves much to be desired. But Internet phone calls are fine for sending faxes, and some of your less important long-distance phone calls. An added bonus: You don't pay federal taxes or phone company surcharges. "I don't know that I'll use it if I'm closing the biggest deal of the year," says Rick Waters, CEO of 25-person Web site design firm Webcast 1, of Boca Raton, Fla. "But if I'm just maintaining the account, then I would." Using technology from Net2Phone Inc., Webcast 1 has reduced its monthly long-distance bill by \$400.

Up-front costs are modest: about \$1,800 for the hardware device, known as a VoIP gateway, needed to handle up to eight phones; and about \$200 to install each device. Of



OPPORTUNIST: Rankin wants to capitalize on bargains by making acquisitions

course, if you want to ensure audio quality, you had best maintain at least one long-distance service contract from a federally regulated telephone company. If you make lots of long-distance calls—say, over \$1,000, your phone company may offer you a discount.

Mergers & Acquisitions

VALUATIONS ON BUSINESSES HAVE ALREADY FALLEN 20% from a year ago and should remain flat for the first quarter of 2002, says Rich Jackim, CEO of Chapman Associates, an M&A specialist in Schaumburg, Ill. Distress sales are likely to increase over the next six months, too, says John Mack, CEO of USBX Advisory Services in Santa Monica, Calif. That means plenty of buying opportunities.

One such opportunist is Ed Rankin, CEO of People Solutions Inc., a 30-person human resources outsourcing and consulting firm in Dallas. In June, he bought a small technology company that had its own human resources outsourcing software. The deal has boosted his revenues by 25%. And Rankin is currently closing two others, both acquisitions of smaller competitors. In 2002, he says he'll go shopping for at least two more companies. "Organic growth is good, but it can be accelerated through acquisitions, Rankin says. "Right now, there are some wonderful bargains out there." Of course, that depends which side of the deal this sagging economy has put you on.

—WITH KEVIN FERGUSON IN BOSTON

A Remote Type

If you want to make money in the global village, it helps to know the neighborhood. Vikram Agrawal knows it well. Raised in family of entrepreneurs in Bangalore, India, Agrawal came to Rensselaer Polytechnic Institute in Troy, N. Y., in 1999. A year later, he won a business-plan competition that helped him raise \$475,000 in venture capital to start Etransmedia Technologies Inc., a transcription service for U. S. doctors and businesses.

It's a simple idea. Clients use digital devices to record audio files, which are sent electronically to typists in Bangalore. About 24 hours later they get back a transcript. In three months, the company has racked up \$1 million in sales. Says Agrawal: "We edge the American companies out by price. And we edge offshore competition out by quality." Next, Agrawal plans to start a call center in India to do billing for U. S. hospitals. Talk about a hometown advantage.

—NAWEEN A. MANGI

AT A GLANCE

WHO: Vikram Agrawal, 26

COMPANY: Etransmedia Technologies Inc.

WHERE: Troy, N.Y.

REVENUES: \$1 million

EMPLOYEES: 4

THE BUSINESS: Transcription of audio files into text

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EDITED BY OTIS PORT

A GOOD CATCH OF ANTIBIOTICS—FROM FISH

MINUTIVE PROTEINS FOUND in the gills of striped bass may hold the key to a whole new family of antibiotics. The small proteins, known as peptides, were discovered by a research team led by North Carolina State University veterinarian Edward J. Noga. Dubbed piscidins, these molecules may explain why bass and other fish are able to fight off a wide range of bacterial assaults in the ocean, Noga says. He and colleague Oskar Liborsky have launched a startup called Norcarex Bio to refine the peptides and test their efficacy against multi-drug-resistant bacteria—a growing problem in hospitals around the world.

Piscidins belong to a class of compounds called peptide antibiotics. Noga and graduate student Uma Silphaduang discovered them in the fishes' immune cells—a type of immune cell common in vertebrates. Indeed, humans also produce numerous peptide antibiotics, a group of researchers at the University of California San Diego report in the Nov. 22 issue of *Nature*. They describe peptides called cathelicidins that are found in tissues of all mammals and inhibit microbe growth in culture. *Neil Gross*

THE WAY: DIGITAL PHOTOS AT TALK (OR SING)

I'VE HEARD THE BUZZ for years. One day soon, software wizards will marry sound with digital images so you can e-mail pictures of little baby to his grandmother, and they'll really come alive. Programs such as Microsoft's PowerPoint already let users embed images and sound in presentations. And some handhelds have toyed with at-



THIS BALLOON MAY BE A RECORD BUSTER

NEXT SUMMER, TWO DAREDEVIL BRITS HOPE TO ASCEND to the edge of outer space in a balloon. Andy Elson and Colin Prescott will try to float up 132,000 feet, or 25 miles, and break a 40-year-old altitude record. That record was set by U.S. Navy pilot Malcolm D. Ross and medic Victor A. Prather Jr. Their balloon climbed to 113,740 ft. in May, 1961—the day before Alan B. Shepard rode a rocket all the way into space.

The new balloon, designed by engineer Elson, 48, will be the biggest ever built—almost as tall as the Empire State Building. Underneath, he and businessman Prescott, 51, will ride in an open gondola, protected from the frigid, essentially airless environment by Russian space suits. The helium-filled balloon will be named after QinetiQ Ltd., the commercial spinout from Britain's Defense Ministry that is footing most of the \$3.5 million tab. The pair will perform various weather and communications experiments for QinetiQ during the 12-hour flight and transmit a real-time broadcast from 25 miles up. The Elson-Prescott team already holds the endurance record for balloon flight: close to 18 days aloft in 1998, when they attempted to circumnavigate the globe but had to ditch off the coast of Japan. And in 1991, Elson piloted the first hot-air balloon over Mt. Everest. ■

tachments that match sound with pictures. But all of that is a far cry from searing sounds straight onto a digital photo. "It's always been the future thing," says IDC analyst Kevin Burden. "We've been hearing promises for 10 years now."

SoundPix Inc. says the wait is nearly over. The Lake Tahoe (Nev.) startup is developing PC software that will let users embed anything from a few words to a whole song in an image. Once the message is assembled, it can

be zapped via computer, cell phone, or a future handheld device with a browser and a color screen.

The software includes security features designed with medical, insurance, and real estate applications in mind. For example, users can record multiple audio clips onto a single image—and specify which recipient hears what clip. This way, a physician could send the same X-ray with different messages to a patient and a fellow doctor. *Roger O. Crockett*

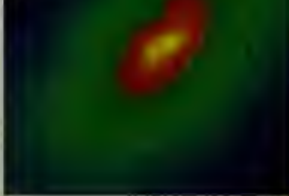
INNOVATIONS

■ A structure-monitoring system being developed at Purdue University might have prevented the Nov. 12 crash of Flight 587—if structural fatigue is what led to the loss of the plane's tail. The system sends high-frequency sounds coursing through metals and composites. Then, radarlike receivers analyze the sound waves to predict impending failure. Aside from planes, wear-prone parts of turbine generators, construction vehicles, and army tanks could be monitored.

■ Researcher David Cliff at Hewlett-Packard's British lab is developing a digital disk jockey to keep dancers hopping. It patches together various sound tracks, then speeds up or slows down the tempo depending on the vibes it gets from the dance floor. These are relayed by special wrist radios that track dancers' arm movements and pulse rates.

■ What followed the Big Bang that created the universe some 15 billion years ago? Until recently, the world's biggest supercomputers couldn't shed much light because they could run only crude simulations of the formation of the very first star and its follow-on relatives. Now, scientists at the University of California, San Diego, are sharpening our picture of the first stars using the hot new IBM supercomputer at the San Diego Supercomputer Center. It can chew through as many as 1.7 trillion calculations a second.

IS THIS HOW THE FIRST STAR WAS BORN?



Cover Story

A dramatic illustration of a woman with long, wavy blonde hair, wearing a white surgical mask and a white lab coat. She is holding a balance scale. The left pan, which is lower, is filled with a large quantity of white, yellow, and red pills. The right pan, which is higher, contains several US twenty-dollar bills. Her right hand is raised, holding the top of the scale's beam. The background is dark and moody, with a spotlight effect on the woman and the scale. The overall tone is somber and critical, suggesting a comparison between healthcare costs and the value of human life.

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For drugmakers, this fall's Cipro saga contains the germ of a potential nightmare. No, not because of worries that the antibiotic is scarce or that anthrax will bring America to its knees. The scary part for the industry was watching tough-talking Health & Human Services Secretary Tommy G. Thompson bully Cipro manufacturer Bayer into slashing its price by threatening to take away its patent-protected monopoly.

In one fell swoop, Thompson highlighted the fact that Cipro costs about 10 times as much as equally effective drugs, he em-

boldened Brazil and other countries to break patents to lower drug costs, and he set a worrisome precedent for future government meddling in the cost of medicines. If a free-market Republican Administration

an force Bayer to cut its price, how will the government be able to resist stepping in when the soaring cost of a future Medicare drug benefit threatens to break the bank?

Make no mistake: In a few years, America's bill for drugs could well test the health-care budget because of a simple whammy of expensive new medicines, a tremendous jump in the use of drugs, and the aging of the population. Already, there are drugs such as Pharmacia Corp.'s colon-cancer treatment, Camptosar, that can cost more than \$60,000 per patient per year. And as today's gene wizardry becomes tomorrow's amazing new drugs, some of the price tags will be totally amazing.

The nation's drug bill has been rising at 14% to 18% a year, and for 2001 it will be between \$10 billion and \$170 billion, according to private sector estimates. The bill will climb even faster as seniors' ranks

grow with aging baby boomers. The upshot: a clash between rising costs and payers' ability to foot the bill. "The country has already started on the collision course," says Alan L. Schwartz, director of the Center for Health Policy at the University of Pennsylvania's Wharton School. "We simply don't have enough money to pay for these future technologies." The prospect of this collision is already prompting insurers, governments, and other payers to take direct aim at the pharmaceutical industry. To keep costs from soaring even higher, health maintenance organizations (HMOs) and pharmacy benefit managers (PBMs) are trying everything from pushing patients to

use generics to demanding that drugmakers prove that their new medicines are cost-effective. States from Florida to Michigan are legislating discounts for residents, and companies like Chrysler are teaming up with others to negotiate lower prices. Meanwhile, a new World Trade Organization agreement gives other countries more leeway to make cheap knockoff drugs in times of medical need. All this comes at a bad time for Big Pharma, which is facing the imminent expiration of patents on many of its blockbusters and fewer-than-expected new drugs in the pipeline. "We are under enormous pressure," says Novartis Chairman and Chief Executive Daniel Vasella.

The industry is fighting back. In an advertising campaign, it is arguing that spending more on drugs actually saves money by reducing costly hospitalizations and other health-care expenses.

Companies are also rushing to assure patients who cannot pay that they won't be left out. Glaxo-SmithKline PLC announced in October that it would give discounts of 30% to 40% to needy elderly Americans, for instance. Novartis is providing its \$28,000-per-year leukemia drug, Gleevec, free to those who can't afford it, as well as discounting other drugs for poor people. And the bioterrorism attack "gave the industry the opportunity to put its white hat back on," says Lehman Brothers Inc. analyst Nancy Myers. Glaxo, Bristol-Myers Squibb, and others rushed to donate antibiotics and expertise to the government. "If industry doesn't make such an effort, we will face a backlash," says Vasella.

Big Pharma's do-gooders, however, can't paper over the underlying issue: Just how will the nation cope with the rising cost of drugs? It's a far from simple question. A close examination shows that this is not a black-and-

DRUG PRICES WHAT'S FAIR?

HOW CAN WE ENCOURAGE
RESEARCH AND STILL KEEP PRICES
WITHIN REACH...
FOR CIPRO AND BEYOND?

BY JOHN CAREY AND AMY BARRETT

white case of medical breakthroughs that bust the bank or of lifesaving drugs priced out of reach of ordinary citizens. Instead, the tale is replete with paradoxes and puzzlements. Take one classic example: Some expensive new drugs, such as Gleevec or cholesterol-lowering medicines, do save money by reducing the need for expensive bone-marrow transplants or bypass operations. Yet in terms of overall health-care costs, a quick death is cheap. By living longer, patients will get other diseases that require more costly care. On the other hand, premature deaths rob the economy of productive citizens and workers.

These complexities make it extremely difficult to figure

out whether any given drug increases or decreases health-care costs. Add in the larger picture, including productivity and quality-of-life measures, and the economics gets even murkier.

The whole debate is further muddled by the country's schizophrenic attitude toward drugs and drugmakers. Americans want powerful new medicines, along with smashing returns for stockholders. At the same time, people demand that drugmakers deliver their remedies at prices ordinary folks deem reasonable. If drug prices soar, Americans worry that medicines will have to be rationed by the patient's

ability to pay, which wounds our sense of social equity.

So how is it possible to understand this complex situation?

Cover Story

DRUG PRICES: WHAT'S FAIR?

And more important, what can be done to soften the impact of the collision between soaring costs and ability to pay?

What follows is a step-by-step tour through some of the key questions and answers. The bottom line: The U.S. does spend more than it needs to on drugs, although in certain cases it should be spending more. Drugmakers need big profits to provide the innovative new medicines that the public demands—even though companies also need to boost research and development productivity. Market forces are already beginning to rein in the drug-cost monster, but there are steps the health-care system should take to speed the trend. BusinessWeek estimates that these steps could cut the nation's annual drug bill by as much as \$15 billion and reduce other health-care costs as well.

WHY WE SPEND TOO MUCH ON DRUGS

One fact is crystal clear: The U.S. drug bill is higher than need be. Americans take more drugs than necessary, often popping expensive pills such as Cipro when cheaper ones will do. And because of overuse and misuse, studies estimate, the U.S. wastes an extra dollar for every dollar spent on drugs—fixing the ills medicines cause. Some patients don't get, or don't take, the right prescription, for instance, leading to lost work or unnecessary hospitalizations. Others suffer because of dangerous side effects or drug interactions. One famous 1998 study in the *Journal of the American Medical Association* estimates that adverse reactions to drugs in U.S. hospitals may cause more than 100,000 deaths a year. "When you see someone taking 14 drugs, the last seven are typically to treat the side effects of the first seven," observes Albert I. Wertheimer, director of Temple University's Center for Pharmaceutical Health Services Research.

Reduce these problems, and the savings are huge. If the estimated \$150 billion spent each year to fix drug havoc could be cut to \$50 billion, "we'd save enough to afford a Medicare drug benefit," says J. Lyle Bootman, dean of the University of Arizona's College of Pharmacy.

For each of these problems, there's plenty of blame to go around. Employers, doctors, and health insurers often fail to steer patients toward the drugs that offer the best value or to teach them to take the medicines properly, experts say. Meanwhile, Americans too readily seek pharmaceutical solutions to ailments that are better tackled through prevention. Public-health officials warn that we are on the cusp of a budget-busting diabetes epidemic, triggered by Americans' couch-potato habits. The incidence of the disease has jumped more than 33% since 1990, mirroring a similar rise in obesity.

Drugmakers are culpable, too—although not necessarily because of the prices they charge. Selling drugs is, after all, a business, and companies have a duty to shareholders to maximize profits, observes Dr. Alan M. Garber, professor of

THE FORCES THAT MOVE DRUG COSTS



UPWARD PRESSURE

MARKETING BLITZ

While 80,000 sales reps in the U.S. stoke doctors' interest in drug Pharma drives demand by ads directed at consumers. Spending on ads nearly tripled between 1997 and 2000, hitting \$2.3 billion. F say the strategy pays off—witness the Viagra boom.

PATENT GAMES

Patent-holders use lawsuits to tie up generic-drug makers for years. For some, this wins to persuade patients to switch to a newer, patented product. AstraZeneca

is trying to move users from its \$5.8 stomach drug Prilosec to the newer Nexium.



UNPRODUCTIVE RESEARCH

Drugmakers have upped research spending in recent years—spends \$4.9 billion annually; Merck, about \$2.6 billion—but with big payoff in productivity. Hefty up-front investments in genomics, in particular, have so far failed to yield a big crop of new compounds. Pharma is licensing more drugs from biotech companies, but such deals don't come cheap.

PRICEY BREAKTHROUGHS

Breakthrough drugs with hefty price tags are coming to market, including rheumatoid arthritis drugs, which can cost nearly \$12,000 a year, and Novartis' cancer agent Gleevec, which can cost \$28,000. Other cancer drugs could turn the disease into a chronic condition—prolonging lives but at a tremendous cost.

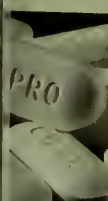
Pharmaceutical costs are pulled in different directions by a panoply of social and economic pressures. Below are some of them:



DOWNWARD PRESSURE

PHARMACEUTICAL HEAT

Bayer, under pressure from the U.S. government, slashed the price of Plavix, it was following a well-trodden path. Merck, Bristol-Myers, and others have already cut prices on AIDS medications sold in Africa. Other pharmaceutical companies will come under similar pressures, in the U.S. and abroad, if their products fit the bill in times of emergency.



PATENT EXPIRATIONS

In the next five years, drugs with U.S. sales of \$35 billion will lose patents or other forms of market exclusivity. In August, when a generic version of the antidepressant Prozac was launched, pharmacy benefits manager Merck-Medco switched 80% of the patients in its massive mail-order operation to the generic in just one week.

PHARMACO-ECONOMICS

Government agencies, and other payers are trying to figure out which drugs offer the most bang for the buck. The military is requiring that all new allergy patients be treated with Allegra, which is less than half the price of common Claritin, saving millions per year. Another example: switching cheap ibuprofen for expensive Vioxx.

MARKET FORCES

In addition to pushing doctors to prescribe generics, payers are giving doctors more incentive to pick cheaper alternative drugs by requiring that they pay more out of pocket for the more expensive choices. Almost 90% of people in HMOs have such "tiered co-pays," up from 5% just a few years ago.

medicine and health policy at Stanford University. "It would be unfair to portray the industry as greedy or irresponsible if they charge what they can get," he says. But companies may cross an ethical line when they market expensive drugs to those who don't need them or manipulate the patent system to extend their patent-protected monopolies.

Today, the rise in drug spending is not being fueled by headline-grabbing, \$15,000-a-year AIDS or cancer drugs, which are used by too few people to add up to megabucks. Instead, Merck-Medco, a large PBM, figures that more than half of the projected doubling in its spending over the next five years will come from just two main types of drugs: cholesterol-lowering and other heart-related medications, and neurological medications, such as psychiatric drugs or painkillers, that are used by tens of millions of people.

When they develop new classes of drugs, companies typically price them far higher than the older medicines used for the same conditions—even if the extra benefits are small. Expensive drugs called calcium channel blockers, for example, are routinely prescribed for patients with high blood pressure, even though studies show that cheaper beta-blocker and diuretic drugs can work as well or better.

What's more, drugmakers market many medicines directly to consumers, spending billions on ads that critics say are often misleading. "Pharmaceutical companies are coming out with these very expensive new drugs to replace existing drugs, sometimes in the absence of good evidence that their

DRUGMAKERS' PRODUCTIVITY IS GOING DOWN

value is worth the extra costs," charges Dr. Sharon Levine, associate director of Kaiser Permanente's physician unit. For instance, the heavily advertised painkillers Celebrex and Vioxx, with combined world-

wide sales of \$5.6 billion, "are not more effective than Motrin, but they cost up to 60 times as much," Levine says. The new drugs do offer an important benefit for some patients: less stomach bleeding. But most people have no problem taking the older drugs. The Food & Drug Administration has cracked down on Pharmacia for painting too-rosy pictures of its drug's merits in consumer-focused ads.

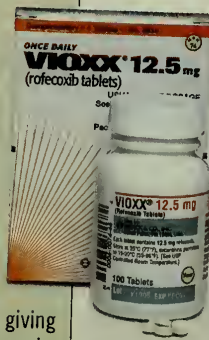
Meanwhile, one study found that as many as two-thirds of people taking Schering-Plough Corp.'s heavily advertised Claritin and other allergy medicines don't even have allergies. Schering responds that patients wouldn't take Claritin if it didn't work. But "there's no doubt that the direct-to-consumer advertising increases drug consumption," says Barrett A. Toan, chairman and CEO of Express Scripts Inc., a PBM. Claritin sales? About \$2.2 billion per year.

WHY DRUGS COST SO MUCH

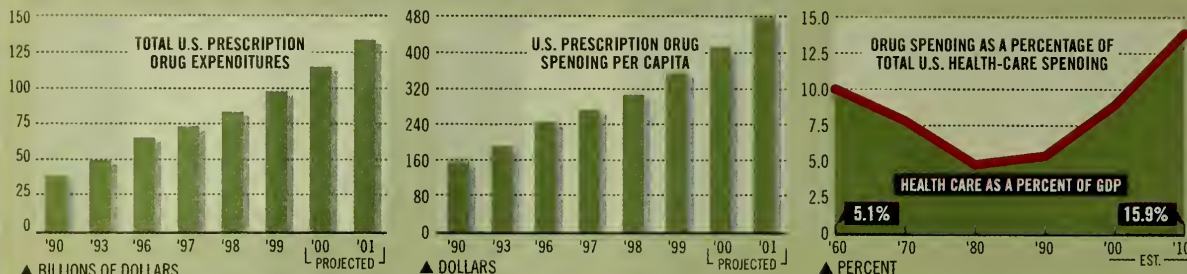
Investors won't fault companies for persuading consumers to buy more products than they actually need. And the more money drug companies make, the more they can spend developing tomorrow's lifesaving medicines. Indeed, industry executives argue that if prices were squeezed, the world can forget about new and better drugs.

Many economists agree—up to a point. Consider today's protease-inhibitor drugs for AIDS, which have dramatically cut deaths and hospital costs for those with HIV. If Congress had put price controls in place back in the early 1990s when lawmakers were screaming about high prices, "there would be no protease inhibitors now," says Eugene M. Kolassa, professor of pharmacy at the University of Mississippi. While drugmakers would have tried to develop AIDS drugs anyway, they would not have moved as quickly as they did without the promise of blockbuster revenues.

On the other hand, drugmakers wouldn't need to charge



HOW DRUG SPENDING IS RISING



Data: Centers for Medicare & Medicaid Services

such high prices if they could boost R&D productivity. Overall, the average tab for developing a new drug is \$500 million to \$880 million, the industry says. But the amount actually spent on any one marketable product is roughly one-quarter of that.

To understand why, just look at the drug-development process. In the past, scientists made many variations of existing chemicals and tested them to see which ones had the ability to fight a particular disease. Now, with the explosion of information about genes and biology, the process has gotten more complicated—and oddly enough, more difficult. Researchers try to identify the best target in a particular disease—for instance, a damaged gene that causes cancer—then they make a drug to hit the target and cure the disease.

That process can take 10 years or more. Such a long period means that about half of the calculated \$500 million to \$880 million total isn't actually spent at all. Instead, it's the opportunity cost—the measure of what the money tied up in the drug for so many years could have earned with alternative investments.

Moreover, there are pitfalls every step of the way. Making drugs from previously unexplored types of

corollary, therefore, is that reducing the failure rate and the overall development time can dramatically cut total R&D costs. Pfizer's Niblack, for one, believes that new technologies for screening drugs, smarter clinical trials, and other measures will soon slash the attrition rate. But for now, industry productivity is going down and R&D costs are going up. With all the advances in biology, "we had expected a lot more [new drugs] by this time," admits Fred Hassan, chairman and CEO of Pharmacia. "The reason is that the new stuff is difficult to find."

That's why drugmakers are increasingly letting other take the big risks. More and more, they're filling their pipelines by picking up drugs from biotech corporations and startups—after the medicines have already shown promise in clinical trials. Case in point: Bristol-Myers Squibb's \$1 billion investment in ImClone Systems' promising cancer drug, C22.

Although drugmakers spend billions on R&D, they also rake in huge profits. Too big, some analysts believe. Since 1988, the return on equity of the five biggest U.S.-based drugmakers—Merck, Eli Lilly, Pfizer, Pharmacia, and Schering-Plough—has averaged 30% a year. Last year, it was 36% compared with 27% for Microsoft Corp. and 21% for companies in the Standard & Poor's 500-stock index.

Industry execs say that the high returns are justified on the basis of the high risks they take to develop drugs. But economists point out that such risks ought to translate into variable returns—and drugmakers show a consistent high return on equity compared with companies in other sectors. Merck's return, for example, has not fallen below 28% since 1988. "If you went to Vegas with \$1,000 and routinely can back with \$1,400, could your family accuse you of gambling?" asks Alan Sager, co-director of the Health Reform Program at Boston University.

By this analysis, Big Pharma's prices are higher than needed to cover R&D costs and risks. But that's not surprising because the price for a drug typically has little to do with its development costs. Instead, pharmaceuticals are just like any other product: The producers charge what the market will bear. The usual price calculation includes an assessment of the medical benefits the drug brings and how much competition it faces. If a new drug

Cover Story

DRUG PRICES: WHAT'S FAIR?

chemicals increases the chances of problematic side effects, explains John F. Niblack, R&D chief at Pfizer Inc. And new targets that look great in the test tube or in animals often don't pan out in humans. "If you develop a drug that hits one of those unvalidated targets, you are likely to spend a lot of money and find out that it doesn't work," says Niblack.

That's why, of the thousands of potential drugs that start development, only a tiny percentage make it into animal tests. Only a few of those will be given to people in so-called Phase I trials to test for safety. Then come Phase II trials for safety and the first hints that a drug works. And then Phase III: wide-scale tests to gather proof of safety and efficacy. Only about 1 in 10 of the drugs that enter human trials makes it through Phase III.

The high attrition rate means that about half of drugmakers' actual R&D spending represents the price of all the failed projects. The



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IF DRUGMAKERS
DON'T HELP OUT,
"WE WILL FACE
A BACKLASH"**

NOVARTIS CEO VASELLA

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best use
of your company's
time and money?

hint:
it isn't
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TOMORROW'S BLOCKBUSTERS

New medicines with mass appeal will keep drug costs soaring

PRODUCT AND APPLICATION	COMPANY	2005 PROJECTED SALES MILLIONS
CIALIS Erectile dysfunction	Eli Lilly/ICOS	\$2,000
ARCOXIA Arthritis and pain	Merck	2,000
VANLEV Hypertension	Bristol-Myers Squibb	2,000
BEXTRA Arthritis and pain	Pharmacia/Pfizer	2,000
CLARINEX Allergy	Schering-Plough	2,000
CRESTOR Cholesterol reduction	AstraZeneca	3,500

Data: SG Cowen Securities Corp.



fers a lifesaving treatment where none existed before, or if it helps avoid costly hospital procedures, the price can be astronomical. An example is Genzyme's drug Cerezyme for the rare Gaucher disease, which has an average price tag of \$170,000 a year. The alternative, after all, is severe disability or death. "In reality, if a drug is going to save a life, we will find a way to afford it," says C. Daniel Mullins, associate director of the Center on Drugs & Public Policy at the University of Maryland School of Pharmacy.

And when it comes to new painkillers or other drugs, Big Pharma has been able to get away with charging high prices because most consumers, shielded by their insurance coverage, have little or no incentive to pick cheaper options, explains Kenneth L. Sperling, head of health-care analysis at Hewitt Associates LLC. That, however, is beginning to change, as the health-care system takes a harder look at the value of drugs.

SO WHAT IS THE VALUE OF DRUGS? AND CAN WE AFFORD THEM?

Despite the concern over drug costs, pharmaceuticals represent only about 9.5% of the nation's \$1.4 trillion health-care bill. In the U.S., drug spending is less, per person, than it is in many European countries, which have lower per capita medical bills. To economist H.E. Frech III of the University of California at Santa Barbara, the conclusion is clear: If the U.S. spent more on drugs, health-care costs would be lower. Argues the University of Mississippi's Kolassa: "We should be happy that pharmaceuticals are the fastest-growing component of the health-care budget, because it means that other components aren't growing as fast."

There's some merit to the argument. Health experts can

point to case after case in which a new drug or a boost in drug use replaces hospital outlays. The ad-

vent of stomach-acid blockers, for instance, dramatically slashed the number of ulcer surgeries. Even at \$28,000 per year, the leukemia drug Gleevec is cheaper than a bone-marrow transplant. And a newly updated study by Columbia University economist Frank R. Lichtenberg finds that for every extra dollar spent replacing many older drugs with new, costlier ones, four dollars are saved in medical costs.

Even WellPoint Health Networks Inc. in California, which has been particularly aggressive at trying to curtail drug spending, has learned that additional drug use sometimes can save money. In 1998, WellPoint became concerned about rising emergency-room and hospitalization costs for its asthma patients. For help, the company turned to Kathleen A.

Johnson, a pharmaceutical economist at the University of Southern California. She helped set up a program to identify patients at risk and train them to monitor their symptoms and use drug inhalers when needed. "We found that even though drug costs went up [about 20%], hospital admissions and emergency-room visits went down by 80%—and overall costs by 48%," says Johnson.

But as usual, the story is more complex than it seems. Many drugs don't replace costly procedures. Glaxo's new flu drug, Relenza, simply shortens flu symptoms by a day or so. Other drugs may cut some costs but raise others. Do all drugs save money, for instance? "The jury is still out," answers Maryland's Mullins. Yes, AIDS-related hospitalizations and deaths are down. But the drugs also have serious side effects. HIV-infected patients are now getting cancer, heart disease, and other diseases that are costly to treat.

Even drugs that help prevent hospitalizations or surgery may increase health-care costs—because so many people take them. Cholesterol-lowering "statin" drugs reduce the need for bypass and other heart operations. But they are now used by millions of Americans, and scientists estimate that only a minority would have needed operations without the drugs. The total statin bill: \$15.5 billion this year, rising to \$24.6 billion by 2005, predicts SG Cowen Securities Corp. Economists say it's not clear whether the health-care savings would be greater than that.

The problem of paying will grow even more complicated. Companies are experimenting with genes that help build new blood vessels to the heart, for instance, or cancer treatments where patients' own tumor cells are used to boost the immune system's ability to fight the disease. These approaches, so customized for each individual, will be hugely expensive. If they work, Americans will demand them. "The limiting factor will be affordability," says Dr. August M. Watanabe, executive vice-president for science and technology at Eli Lilly & Co. "Can society afford them for its citizens?"

The nation can easily pay the tab, economists generally agree. "We're a long ways from reaching any limit," says Harvard University economist David Cutler. After all, he points out, GDP is rising faster than total health-care costs. That leaves a bigger and bigger piece of the pie to pay for drugs.

But while a rich nation like the U.S. can foot the bill, many Americans will be left out. In fact, de facto rationing is already common. Look at two of the latest drugs for rheumatoid arthritis, Immunex Corp.'s Enbrel and Johnson & Johnson's Remicade, both of which cost \$10,000 to \$12,000 a year. The companies do offer some assistance to poor

AS BOOMERS AGE
PRESCRIPTIONS
WILL INCREASE

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DRUG PRICES: WHAT'S FAIR?



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tients. But, says Dr. John H. Klippel, medical director of the Arthritis Foundation, "just because of the expense, they are largely limited to people who have insurance plans that pay for them."

Overall, when it comes to health care, "we're moving to a three-tier system: the haves, the have-littles, and the have-nots," says Wharton's Hillman. "The more technology we have and the more that it costs, the more we have to ration it."

WHAT WE SHOULD DO

For Americans worried that they will be among the have-nots, the good news is that the market has begun to rein in drug costs. Insurers and payers will also get a break because blockbuster drug after blockbuster drug, from Claritin to stomach drug Prilosec, is coming off patent or other monopoly protection. Overall, drugs that are now worth \$35 billion per year in U.S. sales could face competition from generics by 2005.

Large employers such as General Motors Corp. stand to reap windfalls. "If you take a look at three of the drugs that will lose exclusivity—Prilosec, Claritin, and Glucophage—we are talking about \$75 million in potential savings for GM over a three-year period," says Cynthia Kirman, GM's director of pharmacy. That's why insurers and PBMs are already pushing generic drugs hard. When Prozac went off patent recently, Merck-Medco was able to convert 80% of mail-order customers within a week—an amazingly quick substitution. The savings from the coming flood of generics? Up to \$3 billion per year.

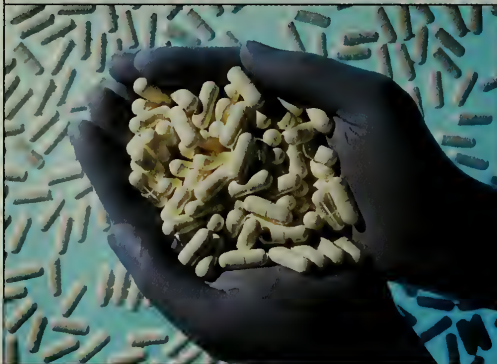
Drugmakers are responding as many other companies would—by protecting their profits. For example, they're doing everything in their power to delay competition from generics, sometimes using tactics that even some drug company execs call "brazen" and "embarrassing" (page 70). Generic competition is not the only threat, however. In the past couple of years, the market has also begun to generate another set of checks and balances on drug prices, called pharmaco-economics. In essence, experts scrutinize the value of individual drugs, aiming to get more bang for the buck.

Pharmaco-economics is already slowing the rise in drug costs for insurers and other payers. In Britain, for instance, a government panel made the controversial recommendation that

RX FOR DRUG COSTS

The following steps might help to slow America's rising tab

- ▶ Close legal loopholes that Big Pharma uses to delay generic competition.
- ▶ Lower unnecessary health-care and drug costs—from adverse drug reactions to over-prescriptions—by curbing drug misuse.
- ▶ Require insured patients to pay a percentage of a prescription's cost out of pocket, with percentages rising for more expensive choices.
- ▶ Disseminate information on the value of drugs—i.e. how well one drug works compared to the alternatives.
- ▶ Reduce hospitalizations and later drug costs by promoting preventative steps against heart disease, diabetes, and other problems.
- ▶ Tighten rules on advertising drugs directly to consumers. The ads often encourage consumers to select pricey drugs over cheaper ones that work just as well.



peting Claritin. The savings: \$7 million in fiscal 2001.

Kaiser Permanente is another believer in pharmaco-economics. Under its plans, only 6% of arthritis patients—those at higher risk for gastric bleeding—get expensive Cox-2 inhibitor painkillers like Vioxx. The rest take cheap ibuprofen. Nationwide, the ratio is 50-50. "If people can be switched from drugs of very little marginal benefit to drugs that are as good and a lot cheaper, there is an opportunity to save many millions of dollars," says Stanford emeritus professor Alain C. Enthoven. With seed money from BlueCross BlueShield, Enthoven is helping to set up an institute, Rx Intelligence, to provide drug-effectiveness data that insurers can use to save money.

Meanwhile, insurers are giving patients incentives to choose cheaper drugs. According to a spring 2001, survey by market researcher Scott-Levin, 50% of people enrolled in HMOs tracked by the firm were in three-tiered prescription drug plans up from 5% just three years previously. In such plans, patients typically pay little or nothing for generic drug. They have a bigger co-pay for the brand-name product and a still higher co-pay for the most expensive drug.

Some cost-cutting tactics can be risky, leaving some patients with substandard treatments. Economists have shown that simple-minded measures, such as capping drug benefits, can actually raise overall costs since patients may not get the medicines that work best. But done correctly, with the emphasis on effective treatments instead of drug costs alone, this type of scrutiny can lead to better care.

One model, pharmacists say, is the approach used by Active Health Management for companies such as Merrill Lynch and Sears, Roebuck & Co. The idea: Give people more medical attention, not less. When doctors find and treat diabetes, heart disease, or other illnesses early, hospitalizations decline, yielding savings of more than \$100 per person per year, calculate Dr. Lonny Reisman, CEO of Active Health Management.

Inevitably, the nation's drug bill will continue to rise, fueled by the introduction of new drugs and by aging baby boomers now reaching their prime prescription years. "I think we will pay more for drugs and we will have less available for other things," says Express Scripts' Toan. But it is with America's power to use those drugs more effectively.

Health-care experts say there are some simple remedies. The nation's doctors and hospitals should be able to trim scores of billions per year by avoiding health-care costs that occur when drugs are used incorrectly. Steps include computer systems to spot dangerous drug interactions and better patient education about the need to take medicines as prescribed. Health care must also harness market forces more effectively. Back in the 1960s, when Americans paid out of their own pockets for drugs, consumers had a strong incentive to pick the

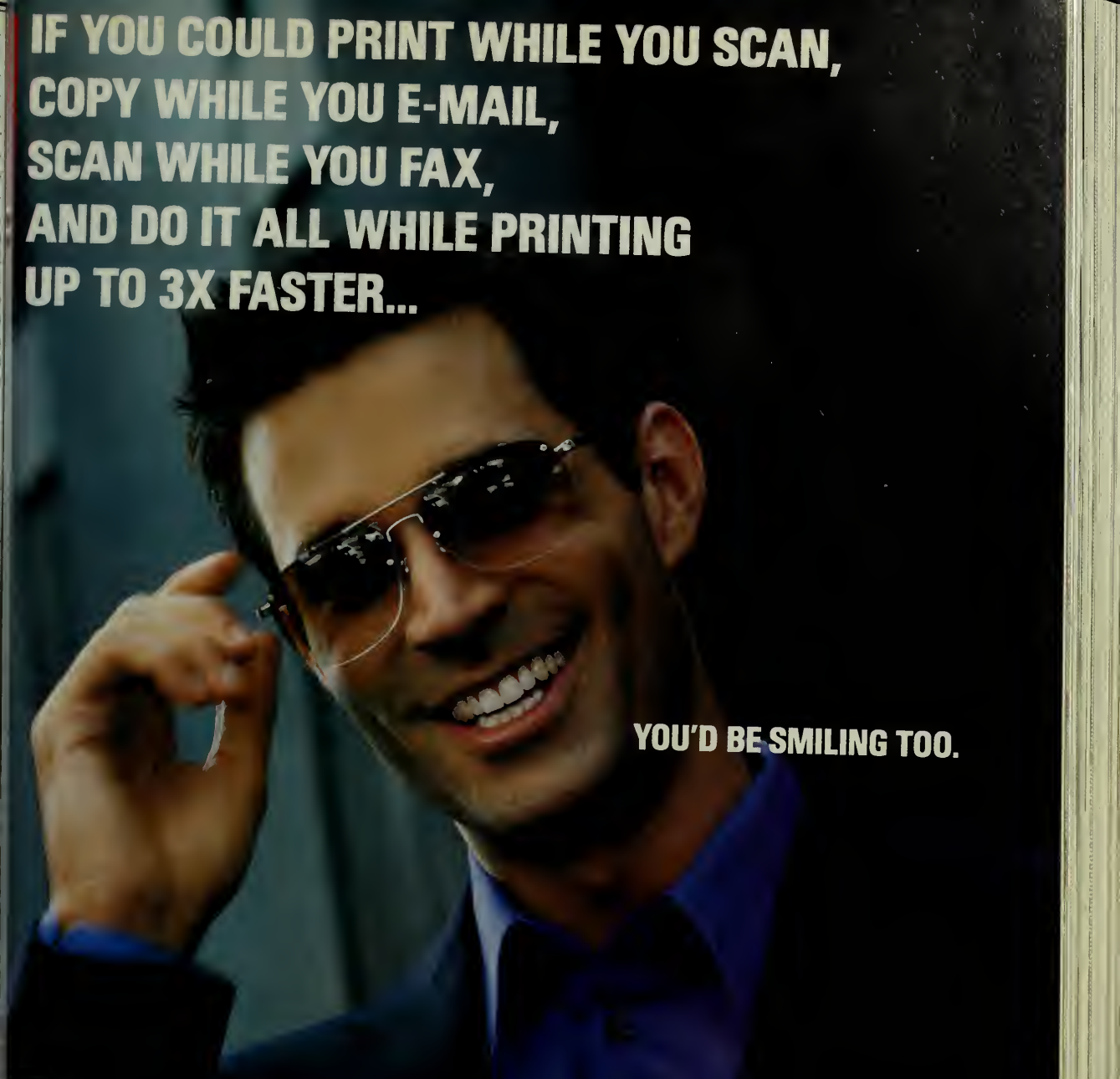
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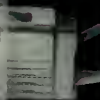
DRUG PRICES: WHAT'S FAIR?

Glaxo's Relenza not be made available to the public through the National Health Service. The benefits didn't justify the cost, the panel said. Similarly, U.S. military pharmacists have decided that all new patients with allergies will be put on only one allergy drug, Allegra. The government has negotiated a price of 60¢ per daily dose for Allegra, less than half the cost of com-

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medications that offered the best value. That incentive vanished when insurers began to pick up the tab. But it could be restored and boosted by expanding use of tiered co-pay plans, saving about \$1 billion annually. Or for more savings, insurers could require patients to shoulder a specified percentage of each drug's cost; the percentage would increase for more expensive drugs. The nation could also educate consumers, doctors, and

Cover Story

DRUG PRICES: WHAT'S FAIR?

payers about which drugs deliver the most for the money, by setting up an independent pharmaco-economic institute. The information it provides could shave \$10 billion or more off the annual drug bill, economists estimate. In addition, Congress could close loopholes that drugmakers use to delay introduction

of generics. Tightening rules for advertising drugs directly to consumers could reduce overuse of expensive drugs. And Big Pharma must learn to cope with the flood of new knowledge about biology to boost its productivity.

The future could get ugly—not just for have-nots. Maryland's Mullins, for instance, fears that the health-care system may decide not to pay as much for treatment for those who helped bring on their own illnesses, such as smokers. Medical progress, though, will clearly continue on its current fast track. "America is in love with innovation—and it wants new drugs," says Jean Paul Gagnon, director of public policy at Aventis Pharmaceuticals. Now, we need to figure out how to pay for those drugs without breaking the bank.

With Arlene Weintraub in Los Angeles, Catherine Arnst in New York, Kerry Capell in London, and Michael Arndt in Chicago

FIFTY WAYS TO KEEP YOUR PATENT

In the next few years, blockbuster drugs generating \$35 billion in U.S. sales will lose patent protection or other forms of exclusivity. That means generic drugmakers can quickly launch cheaper knockoffs, yielding potentially huge savings for insurers and big employers.

But will that really happen? Drugmakers have developed elaborate strategies for extending the lives of their aging blockbusters. For every case like the recent launch of a generic Prozac that saves payers millions, there are many more where delaying tactics keep generics at bay for months if not years. In two flagrant cases, big drugmakers paid millions to generic operators who agreed not to rush in with cheaper drugs.

In those cases, the Federal Trade Commission cracked down. But often, Big Pharma has the law on its side. In March, 1998, for instance, drugmaker Apotex Inc. filed to market a generic version of Paxil, a GlaxoSmithKline antidepressant with annual worldwide sales of \$2.8 billion. SmithKline—which had not yet merged with GlaxoWellcome—sued, arguing that the new version would infringe on one of the company's patents. Under current law, the Food & Drug Administration has to put a hold on the generic version for 30 months after a patent suit is filed, or until the matter is decided in court. SmithKline has since flagged the FDA on nine additional patents it says are related to Paxil, and it has sued Apotex over four of those. That starts the 30-month clock all over again. Bernard Sherman, chairman of

Apotex laments: "They can keep us off the market for a hundred years." GlaxoSmithKline contends that the Paxil patents filed with the FDA reflect the innovation of the company's scientists and that generic Paxil would infringe on its patents.

The courts aren't the only weapon in this brand-vs.-generic battle. Bristol-Myers Squibb's \$2 billion diabetes drug, Glucophage, was expected to face generic competition in the second half of this

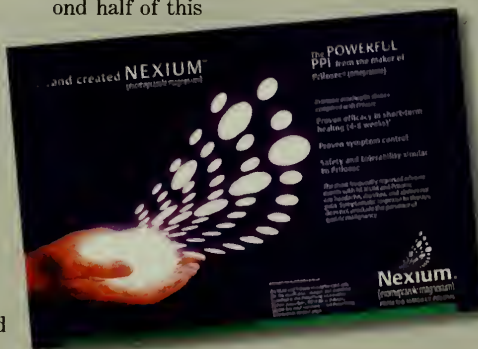
year. At least several months. A Bristol spokesman declined to comment on the legislation but said that the company "is committed as always to protecting our intellectual property."

PATENT PROLIFERATION. If Bristol can hold off the generic onslaught for a few more months, it'll help the company in another tactic that's popular among patent-holders: enticing users to a new drug. Bristol wants to switch Glucophage users to either

Glucophage XR, an extended-release version of the drug, or Glucovance, a pill that combines Glucophage and another diabetes medication. The goal: get lots of patients on a new patent-protected medicine by the time the original Glucophage gets hit with generic competition. AstraZeneca PLC is trying the same tactic with its \$5.8 billion stomach drug, Prilosec. It wants people to switch to a newer version, Nexium. And Schering-Plough Corp. is expected to try something similar with its allergy drug, Claritin.

While drugmakers will argue that these new products are superior, big payers say that in many cases the improvement isn't significant enough to justify the price premium over the generic version of the old medicine. "Some drugs are coming out with just marginal improvements," says Cynthia Kirman, director of pharmacy at General Motors Corp. With the right marketing, though, that may be all a drug company needs to cash in all over again.

By Amy Barrett in Philadelphia



year. But in December, 2000, Bristol got the FDA's sole approval to market Glucophage for use in children for another three years. Generic companies can't include that information on children on their label, so they may not win FDA approval for their products.

In response, language dubbed the "Glucophage amendment" has been added to an FDA-related bill that would clear the way for an immediate rollout of the generics. But sources on the Hill say Bristol is now pushing for a change to that bill that would stall a generic Glucophage for

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PRILOSEC TO STEP
UP TO NEXIUM



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RETAIL RECKONING



There are
just too
many stores
Warning:
Big shakeout
ahead

Marketing

ured by a Nordstrom store and nearly 70 other new retailers, Cheryl Campbell went straight to the Easton Town Center in Columbus, Ohio, on the morning after Thanksgiving. With shopping bags in each hand, the 52-year-old surety underwriter looked like many other shoppers who kicked off their Christmas shopping season by heading to this gleaming outdoor mall. But even by the free-spending measure of the

1990s, Campbell says the last thing this city needed was more new shopping space. "It's really a question of who is going to survive," says Campbell, juggling her shopping bags in front of the new Nordstrom.

Indeed, it doesn't take an expert to see that Columbus can't support all its new stores. The Easton center, built to look like a quaint town with a fake main station and streets like Worth Avenue named for luxe-shopping districts around the world, has doubled in size to 1.6 million square feet since last summer. In addition to Nordstrom, Easton added an Anthropologie store and an American Eagle Outfitters. Meanwhile, ten miles northwest, the new Paris Fashion Place, an enclosed 1.5-million-square-foot mall, opened in October, bringing the city's first Saks Fifth Avenue and 149 other new stores. That's on top of Tuttle Crossing, a 1.1-million-square-foot mall that opened in '97, and six other big malls built previously. "They're all engaged in a big game of chicken," says local retail consultant Christopher Boring of Boulevard Strategies. "There's going to have to be a shakeout."

It's an outcome that's likely to be repeated across much of the nation. Retail discounting may yet save this year's Christmas shopping season from disaster, but retailers are still expecting the slowest holiday sales since the 1990-91 recession. And with so many bargains and promotions, profits take an even bigger hit. That's just starters. With expansion-minded retailers and developers coming off a decade-long building binge, what comes after Christmas is likely to be even more frightening.

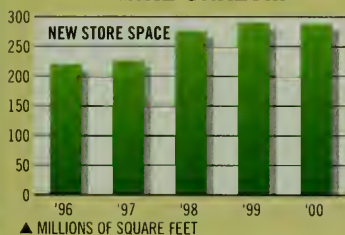
Like the bull market in dot-com stocks, retail is just starting to come apart with its own bubble. The industry added 3 sq. ft. of new store space during the 1990s for every man, woman, and child in the U.S., according to research firm F.W. Dodge, like *BusinessWeek*, a unit of The McGraw-Hill Companies. That 20% growth rate was double the rate of population growth during the decade. Most of it occurred during the past five years, as low unemployment and soaring housing and

equities markets left consumers feeling flush.

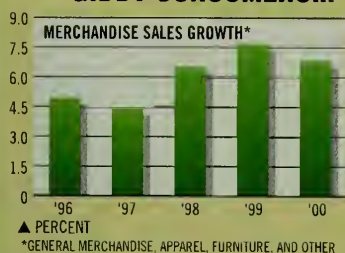
But even under those optimal conditions, many retailers did not perform well, as the total consumer-spending pie was sliced thinner. In fact, as space grew, the industry became less productive. Average operating profit margins for retailers, after rising slightly to 3.97% in 1996, fell each year thereafter to a negative 0.17% in 2000, even as consumer spending accelerated, according to research by U.S. Bancorp Piper Jaffray (chart).

That was in the good times. Now,

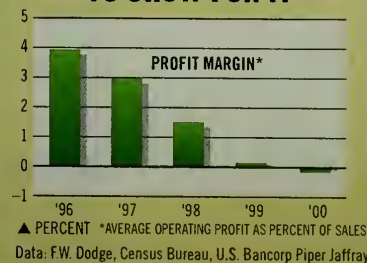
RETAILERS BUILT LIKE CRAZY...



...TO KEEP PACE WITH GIDDY CONSUMERS...



...BUT HAVE LITTLE TO SHOW FOR IT



besides a shaky Christmas, store owners face a recession of uncertain depth and duration, one that could be magnified by another terrorist attack or other external shock. Adding more downside risk is that consumers are laden with record debt and worried about their jobs. There is also evidence that they are fundamentally realigning their priorities, suggesting that they may not return to their free-spending ways even when things improve. "Retailers who expanded, hoping that the consumption boom would continue, are in for a rude awakening," says Stephen S. Roach, chief economist at Morgan Stanley Dean Witter & Co.

This cycle is dealing out huge gains for a fortunate few. The dominant players are bigger and more aggressive than they were in the industry's last downturn. They will probably emerge holding a far greater share of the market, with two or three undisputed leaders in most sectors. In discounting, the likely winners are Wal-Mart Stores and Target; in consumer electronics, Best Buy; and in home improvement, Home Depot and Lowe's.

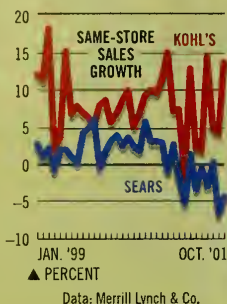
EMPTY SHELLS. The flipside? The next few months will be grueling for chains that are in the crosshairs, such as discounters Kmart, department-store giant Sears, Roebuck, and apparel specialist Gap. There is the potential for a much broader shakeout than last time, as weaker players are gobbled up, and survivors shutter underperforming stores and exit unprofitable product segments. While retailers have always "followed the rooftops," chasing new sources of population growth, this time the landscape could become even more littered with empty or underutilized retail shells, as a relative handful of megaretailers and regional malls consolidate their grip on the business. For shoppers like Campbell in Columbus, the wellspring of choice could narrow again.

No one is expecting the immediate succession of high-profile bankruptcy reorganizations seen in the early-1990s recession, when big department-store chains like Federated and Macy's sought Chapter 11 protection. True, 31 publicly traded retailers have already filed reorganization proceedings this year, more than the annual peak of 25 during the last recession, according to bankruptcydata.com. But most of those were smaller or long-declining operators like Ames Department Stores Inc. or drug chain Phar-Mor Inc. By contrast, most big retailers carry less debt than a decade ago and will be able to hold on longer, even if many of the weakest players have trouble securing new debt lines.

The emerging key players are those that have clear and understandable po-

KOHL'S: WHERE SMALLER TURNS OUT TO BE BETTER

Kohl's has outmaneuvered Sears Roebuck on several fronts. Its smaller stores are usually located in stand-alone buildings, as opposed to shopping malls for Sears. That makes them easier for shoppers to navigate. Plus, Kohl's (right) has carefully nurtured an image of carrying more national brands at better prices.



sitions in consumers' eyes. Just as important, they have developed logistical and financial systems to deliver the goods more efficiently. Wal-Mart has staked out the turf of price leader, while the slightly more upscale Target stands for cheap chic. Kohl's sells leading casual brands but is cheaper and more convenient than traditional department stores. "Customers want a place that is clearly defined so they don't waste their time," says Kohl's Corp. President Kevin Mansell.

"FIVE-YEAR PHENOMENON." This is leaving legions of retailers with identity crises. One thing that is remarkable about this turn of the retail cycle is the number and diversity of major players that were struggling to generate a decent financial return even before the economy headed into recession. That includes nearly the entire department-

stock market balloon, may have left shoppers ready to move away from 1990s-style conspicuous consumption binges in favor of more modest spending focused on the family and home. Already, that is taking a bite out of high-end retailers like Neiman Marcus, Saks Fifth Avenue, and Tiffany & Co. "Before September 11, I used to worry about what that new outfit was going to look like," said Faith Lipton, 30, as she exited empty-handed from the Neiman Marcus store on Chicago's Magnificent Mile. "Now what matters is that my husband is going to come home from work to help raise our child. What used to be necessities are no longer necessities."

Plenty of other retailers are struggling to find a niche in the more crowded landscape, where retail concepts seem to grow stale faster than last night's eggnog. Remember the "softer side of Sears" campaign? Under former CEO Arthur C. Martinez, Sears spent nearly \$4 billion in the mid-1990s to remodel its stores, spiff up its apparel offerings, and be more appealing to women shoppers. In October, new CEO Alan J. Lacy reversed course, saying he would remodel stores again, focus on a narrower but more potent range of apparel lines, and jettison its department-store her-

itage to find a new footing in an elusive niche between discounters and department stores. "We want to carve out unique position," Lacy said.

Join the crowd. A similar strategy is in place at Toys 'R' Us Inc., which in recent years was leapfrogged by discount Wal-Mart. Toys 'R' Us CEO John H. Eyer Jr. is repudiating past attempts to battle the discounters of their turf, narrowing product assortments and looking to add more exclusive items. Warren Kornblum, executive vice-president of worldwide marketing and brand management, recently told licensors that the retailer

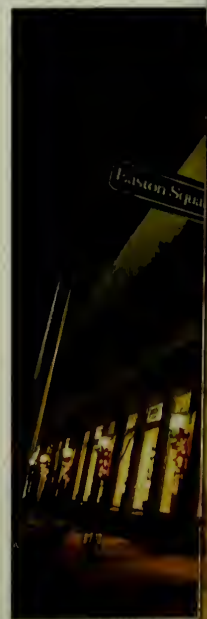
Marketing

store sector, which has been hemorrhaging share to specialty stores and discounters. Whole categories that once seemed so promising, like sporting goods superstores, have been decimated. The resulting stresses could make the coming retail downturn last far longer than the one in the early 1990s. "This could be a five-year phenomenon," warns Edward Yardeni, Deutsche Banc Alex. Brown's chief economist.

The wild card, of course, is the impact of the September 11 terrorist attacks. Surveys of consumers have provided some evidence that the attacks, coming right after the popping of the

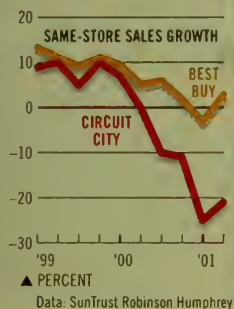
Department stores and other major players were struggling even before the economy headed into recession

THE EASTON CENTER IN COLUMBUS, OHIO, HAS DOUBLED IN SIZE SINCE AUGUST



BEST BUY: TIGHT FOCUS IS PAYING OFF

As Circuit City branched out into the used-car business, Best Buy (right) kept a tight focus on consumer electronics and appliances. Its stores are better located and have more expansive interiors, so it's easier to see products. That makes stores more productive, which is why Best Buy can stock low-profit appliances, while Circuit City dropped them last year.



shes to be viewed as a "large-scale, multiple-outlet specialty retailer. What we're not going to be is a discounter." Will these stabs at reinvention work? Perhaps. But the strong don't plan to off any quarter. Retail juggernauts like Wal-Mart, Target, Walgreen, and Kohl's are adding more new stores than ever, even at the expense of a lower return on investment, they're determined to seize long-term market share. Take Walgreen, which is poaching scarce pharmacists from rivals and opening a new store about every 18 hours, usually right next to a competitor. "It's almost like being dropping on a rock," Walgreen

Vice-President Mark A. Wagner recently assured institutional investors gathered by UBS Warburg in New York. "It's a slow process, but eventually we're going to win the battle."

A steep downturn would accelerate an insidious cycle of weak finances that makes it even harder for the laggards to catch up. And even if they're not shouldering insupportable debt loads, some chains will be on the spot this coming year when unsecured debt lines come due, at a time when banks are retreating from lending, says bankruptcy attorney Conor D. Reilly, senior partner at the law firm Gibson, Dunn & Crutcher LLP. With new unsecured lines out of the question, those who are able will turn to the public-debt or commercial-paper markets, while others "may have to settle for a reduced facility of some kind with security involved," Reilly predicts. That will, in turn, reduce flexibility and constrain store upgrades and other improvements.

Suppliers, contending with their own sales declines, can ill afford to walk away from major retail customers. But they may be less inclined to extend payments and make other concessions to those, like Kmart and Saks, that were most aggressive in extracting concessions during the

boom. Many retailers have "squeezed all the stuffing out of their suppliers over the last three to five years," says Burt Flickinger III, a consultant at Reach Marketing in Westport, Conn. "Now the suppliers have nothing to give, at a time that the appetite among retailers is the greatest." Capping the cycle, as sales and cash flow falter, retailers are forced to cut capital spending, including new stores and the information systems that are crucial to ordering the right merchandise mix and aiming marketing at the most loyal customers.

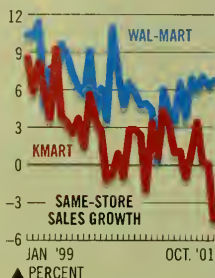
CASH SQUEEZE. Take the battle between Kmart and Wal-Mart. As Kmart's cash flow from operations sank this year, the company cut capital spending twice, to \$1.2 billion from a planned \$1.7 billion. It says it will hold investment at the lower level next year, and is spending all the money it needs. But after accounting for store closings and conversions of some stores to larger formats, it will open a net 10 new stores this year, and just seven next year. In some cases, rather than invest in expansive new sites for its grocery-and-general-merchandise Super K stores, the company is shoehorning food sections into existing discount stores. The cash squeeze could also make it harder to recoup ground it has lost in the important information-systems arena. Inventory control systems were so bottlenecked that at one point last year Kmart had to stash excess merchandise in 12,000 trailers parked at the stores.

Compare that with Wal-Mart. Its capital budget totals \$9 billion, and that will climb by an additional \$1 billion next year. Wal-Mart will open 199 net



WAL-MART STAYING ON TOP BY STAYING CHEAP

In the '90s, Kmart diverted its attention to develop different retail chains, from office supplies to sporting goods. But Wal-Mart (right) stuck to discounting, continuing to lower operating costs and investing in new supply systems while expanding quicker. Now Kmart is squeezed between low-price leader Wal-Mart and the more upscale Target.



new stores this year and projects opening 248 the next, for 46 million sq. ft. of new space. Not only is Wal-Mart taking share from Kmart with new stores, but sales growth at existing Wal-Mart stores have far outstripped the rate of same-store sales growth at Kmart this year.

Similar stories are playing out in other sectors. Walgreen, the No. 1 drug-store chain, is planning a record 475 stores, up three from this year, while No. 2 cvs Corp. is scaling back openings as profits decline. Best Buy Co.,

chief financial officer after helping to take the apparel chain public. Weil has had to fend off investor concerns that American Eagle's brisk 16% annual growth in square footage was insufficient.

But investors can't say there weren't signs of a looming retail glut. The feverish pace of new-store openings couldn't mask the fact that sales were hardly rising at existing stores. For most of the five years through 2000, total retail sales growth, excluding autos, grew at a faster rate than sales at stores open at least a year, according to Bain & Co. That's significant because when total sales grow faster, it suggests new stores are cannibalizing sales at existing stores, lowering overall productivity. Indeed, total sales growth outstripped existing-store sales growth every month during 2000 and the first six months of this year.

Nowhere is this scenario more apparent than among narrowly focused "specialty" apparel stores. Those chains opened 64 million sq. ft. of new space, a 30% increase, between 1996 and 2000, according to securities firm Lazard Frères & Co. Gap accounted for much of that new building. Each year, CEO Millard S. Drexler increased the rate of growth, from 21% in 1997 to 30% in 2000. In that time, square footage more than doubled at its Old Navy, Gap, and Banana Republic units, to 31.3 million sq. ft. Drexler couldn't fund that kind of growth internally. So he turned to the debt markets, going from a net cash position of \$17 million in the third quarter of 1997 to a net debt level of \$1.75 billion for the same period this year. Gap's debt is now 36.5% of total capital. Drexler's gamble didn't pay off. Sales

at existing stores have declined for 18 months in a row. Profits have fallen for six straight quarters, and the company expects a loss for the fourth quarter. Drexler now admits he grew too fast and has slammed on the brakes. "It's easy to get distracted and lose sight of the fundamentals," he said at an investor conference in September.

MORE MERGERS? The new specialty stores were also stealing sales from department stores, but they had on themselves to blame. Following a wave of mergers in the '80s and bankrupt reorganizations in the early '90s, department stores became less willing to take the financial risk of creative merchandising. Except for a small portion in-house brands, they mostly rely on selling the same national megabrands from Tommy Hilfiger and Polo Ralph Lauren to Jones Apparel Group, branded boutiques that make it hard to remember whether you are in a Macy's, a Dillard's, or a Lord & Taylor. "I don't know how Rich's and Macy's survive," says James Crutcher, a retired Atlanta physician who visits units of both in the area's Cumberland Mall. "They're much alike, once you get inside the door you don't know the difference."

Now things are only going to get tougher for department stores. It's hard to figure out who are the likely candidates for the latest round of consolidation. Dillard's finances are deteriorating—sales have been declining, with the company posting a loss for the third quarter and analysts predicting it will post another for the fourth. The Dillard family, which controls 90% of the stock, could be forced to sell if business does

Marketing

the No. 1 big-box electronics store, will maintain its 60-stores-a-year expansion rate, while No. 2 Circuit City Stores Inc. continues to slow openings and gravitate upscale to avoid competing head-to-head on price against the leader.

Very few retailers thought of slowing expansion in the 1990s, even those already wrestling with operational headaches. Indeed, Wall Street was impatient with those who weren't willing to expand as fast as possible. That was particularly true in the second half of the 1990s, when retailers had to compete for investors' dollars against booming tech companies. But the avalanche of funding merely invited poor decision-making, particularly on the real estate front. "The first 50 locations are real good, the next 25 are O.K., the last ones are just deals: 'I'll take the crummy mall in Oshkosh to get a good location in San Diego,'" says Laura A. Weil, a former Lehman Brothers Inc. investment banker who joined American Eagle Outfitters Inc. as

arn. The company won't comment on that possibility. Saks Inc., where cash flow from operations has dwindled as sales at existing stores have tanked, could face problems paying its debt, which is near the highest of any department-store chain. CEO R. Brad Martin denies Saks could run into liquidity troubles, but its junk-bond debt rating and low stock price say otherwise.

As the department stores and discounters have moved closer together in price, the importance of having a clear identity has grown. "The murky middle is where nobody should be right now," says Gwen Morrison, managing director of consulting firm Frankel and Environments. No retailer illustrates this better than Sears. While the chain is robust in home appliances, Sears has little credibility in clothing. Sears needs apparel—it's far more profitable than appliances and electronics, where margins are thin and under mounting pressure from rivals like Best Buy and Lowe's.

HUNTING TASK. That's why Lacy didn't quit the business when he announced the company's restructuring plan in October. But Lacy faces a daunting task moving Sears out of career wear to focus just on casual wear, in which Kohl's is the low-priced leader. Indeed, the two chains sell many overlapping brands, from Levi jeans to Nike shoes. To distinguish itself, Sears plans to create an archiving private apparel brand, much like it did on a smaller scale with its Canyon River Blues jeans brand. But it will be hard to stand out when there are already so many vibrant national store brands, from Federated's Inc. to Target's Mossimo. "When you think about Sears, you don't think about apparel. You think about screwdrivers and appliances," says Emanuel Weintraub, principal at retail consultants Emanuel Weintraub Associates Inc. of Great Lee, N.J.

Although the strongest players are becoming increasingly dominant, that's not to say there won't be opportunity for newcomers—or for those willing to move in a radically new direction. Take the sleepy Fred's Inc., a 374-store chain in Memphis (Tenn.) discount chain that has more than doubled in size in five years around a concept that combines three of the fastest-growing formats—a dollar store, a closeout store, and pharmacy. But those chains that can't deliver on a clear identity, there will be less and less room to maneuver amid the store glut. As the holiday sales pass, the climate only get chillier.

by Robert Berner in Columbus, Ohio,
Gerry Khermouch in New York,
Aixa Pascual in Atlanta and
bu-reports

GOLF

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QUICKLY

(for the Whisky Man).

A round of golf can be played in a half day, which is way too fast-paced for a family like ours.

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SOFTWARE

BIG BLUE'S BIG BET ON FREE SOFTWARE

It's pouring cash into an all-out effort to promote Linux

Over the next month, you may see a television ad called "The Heist." In it, a security guard calls the cops to investigate the disappearance of his company's servers. Then a doughnut-munching techie tells him the company consolidated all the work that was being done by a roomful of servers onto a single mainframe running Linux, the operating system that is available to anyone for free. A tad geeky for you? Put down that remote: IBM says Linux is ready for prime time—and it's spending a third of its TV ad budget this quarter to make the software a household name.

Big Blue's timing couldn't be better. With fears mounting that Microsoft Corp. will grow more dominant in the wake of a proposed settlement of the Justice Dept.'s antitrust suit, companies may be considering alternatives to Microsoft's Windows. Adding fuel to that is the persistent irritation in Corporate America over pricey licensing fees for operating systems, including Windows and Solaris by Sun Microsystems Inc.

Linux, on the other hand, is open-source software that is not controlled by any one company. To boost the Linux movement, IBM is giving away its own software tools—\$40 million worth. IBM

hopes that will spark a blizzard of development around Linux in the same way the free Internet exploded. "Linux will do for software what the Internet did for networks," said IBM President Samuel J. Palmisano at the LinuxWorld Conference earlier this year.

It had better. IBM is placing the biggest bet of any computer maker on Linux. This year, Big Blue will spend \$1 billion, or 20% of its research-and-development budget, to rejigger existing programs or set up new projects around Linux. So far, the \$88 billion computer giant has made the software available on all of its servers, trained 300 consultants to design Linux systems, reworked 2,800 programs created by other companies, and marshaled 7,000 salespeople to spread the gospel. "The more we encourage the development of Linux, the more it will drive our business," says Irving Wladawsky-Berger, the exec heading IBM's Linux efforts.

Wladawsky-Berger is counting on Linux to solve some of Big Blue's longstanding problems. Unlike Microsoft and Sun Microsystems, IBM doesn't have one operating system that runs across all of its machines and throws off juicy profit margins. With multiple operating systems, it's costly for IBM to develop



and support all that software. Linux offers a single system that can potentially span all of IBM's machines. And, by seeing the market with Linux tools and wooing software developers, IBM hopes to regain lost market share for low-end servers. Sun Microsystems Chairman Scott G. McNealy sees the plan as self-serving: "IBM is trying to coopt the Linux developer because the IBM software developer is on life support."

LINUX LOVEFEST

IBM is spending \$1 billion to help increase corporate use of the fast-growing open-source operating system. Here's where the money is going:

SOFTWARE 2,000 programmers—the most of any computer company—are developing Linux versions of IBM software, including its WebSphere application server. IBM also has 10 centers around the world to help other software makers rework applications for Linux.

COMPUTERS From tiny Intel-based servers to huge mainframes, IBM has tweaked all the models in its four server families to run Linux. It's paying off: Bernstein & Co. estimates that IBM will sell \$350 million worth of Linux computers this year, \$500 million worth in 2002.

SERVICES Big Blue is spending at least \$100 million this year to develop training, consulting, and support services for Linux systems. Corporate customers get help on everything from designing Linux systems to online tutorials.

SALES AND MARKETING More than 7,000 of IBM's 30,000-member global salesforce are pitching Linux to customers. And this quarter, one-third of IBM's TV ads are about Linux. The goal: Establish IBM as the leading Linux company.

RESEARCH Most software research at IBM now revolves around Linux. There are dozens of projects, including software tools to make it easier to write Linux applications. Most of the projects are two to three years from showing up in commercial products.



LEADING THE CHARGE:

Wladawsky-Berger says IBM will offer more free training and rebates to resellers

and software, while the rest was spent on hardware and a joint-development effort with IBM researchers.

Today, Linux machines are IBM's fastest-growing server segment, generating about 2.5%, or \$350 million, of IBM's \$14 billion server revenue, estimates Sanford C. Bernstein & Co. analyst Toni Sacconaghi. Next year he predicts, Big Blue's Linux servers could reach \$500 million, or 3.5% of server sales. And that doesn't include software-and-services fees, potentially making Linux a \$2 billion business for IBM in 2002. Linux is "an investment in the future that could be very big," says Sacconaghi.

On the surface, those numbers show promise. But IBM hasn't shined in

every corner of the Linux business. Despite its huge investment in the software, IBM is only the No.3 seller of low-end Linux PC servers, with a 15% share, down from 18% during the first quarter, according to IDC. Compaq Computer Corp. was No.1, with 29% of the market, and Dell Computer Corp. was No.2,

plans to add hundreds of new sales and technical support staff, offer more free training and rebates to resellers, and to pre-install more Linux software on its servers. Wladawsky-Berger expects to see market share gains in 2002.

IBM has its work cut out for it. Not every business is smitten with Linux. A November Goldman, Sachs & Co. survey of 100 technology managers found that 65% had no plans to use Linux in 2002. While Linux is often used to run simple tasks, such as serving Web pages, tech execs say they're reluctant to use it for critical jobs, such as processing transactions, because there aren't enough corporate applications written for Linux.

TEAMWORK. To make sure there is plenty of Linux software, IBM has taken out its checkbook. Some 2,000 IBM programmers have developed Linux versions of IBM's software, including its DB2 database program. Software research at IBM now revolves around Linux: Dozens of projects are in the works, from security programs that manage access to wireless networks to a joint venture with Citizen Watch to develop a Linux timepiece. IBM also is pumping up its sales-and-marketing juggernaut to make the job of running Linux systems a snap. After a salesperson clinches a Linux deal, consultants swoop in to help set up Linux systems or fix more serious problems—for a fee, of course.

Indeed, in the past year, IBM has persuaded big corporations, including oil giant Royal Dutch/Shell Group and Venezuelan bank Banco Mercantil, to embrace Linux. In 1999, IBM helped CBS Sportsline move its pga.com golf site from a Windows system to Linux. The

SOWING SEEDS How will IBM make money? The bulk of its revenue is from software and services, so the spread of Linux could be a windfall

with a 19% share. Both companies gained share, while IBM slipped.

IBM's Wladawsky-Berger says those numbers don't capture the bigger picture. He argues that analysts underestimate IBM's overall Linux position because they do not include sales of mainframes and other high-performance systems. Wladawsky-Berger says IBM's PC server market share dipped because the company has never been a leader in low-end servers, where Compaq and Dell are price leaders. In September, IBM created a new sales post to focus on boosting low-end Linux servers. IBM

site functioned so well that last year, the sports-information provider rolled out Linux to the rest of its online properties, buying 375 servers from IBM to handle the task. Analysts estimate that Sportsline saves \$4 million a year in lower hardware, software, and maintenance costs. "We feel pretty confident that we're going to rely 100% on Linux," says Dan Leichstenschlag, chief technology officer at CBS Sportsline.

Linux is helping CBS save money. Now, IBM has to prove it can profit from Linux, too.

By Spencer E. Ante in New York

Luring developers to Linux is becoming all the rage. Linux is now the test-growing server operating system. By next year, Linux is expected to claim 32% of the server market, up from 14% last year, according to market researcher IDC Corp. Microsoft's ubiquitous Windows, however, will own 47% of the market by the end of 2002, up from 32% in 2000. The big loser is Unix, which is expected to slide to 10% next year from 14% last year.

How will IBM make money on free software? The idea is to use Linux to only sell expensive computers but high-margin software and big-ticket support and consulting services. Because nearly 60% of IBM's revenues come from software and services, Linux plays into IBM's business model better than any other computer maker's. IBM believes the new sales will greatly offset any revenue loss incurred from giving away the Linux operating system. Consider MDS Proteomics, a biotechnology-based drug-research company. IBM bought a Linux supercomputer to help MDS do complex chemical calculations. MDS CEO Frank Gleeson says of its multimillion dollar deal with IBM, "We went toward consulting services

ENERGY

ENRON: RUNNING ON EMPTY

As the collapsed energy giant seems headed for liquidation, many losers count their losses

The fall of mighty Enron Corp.—just months ago one of the most valuable companies in America—is a collapse of mind-boggling proportions. Only last year, Enron had \$101 billion in revenues, a stock-market capitalization of \$63 billion, and a chairman who was a high-profile confidant of President Bush. Yet in a sickeningly swift spiral, the powerful energy trading company tumbled to the brink of bankruptcy in late November—the victim of a botched expansion attempt, an accounting scandal, and the overweening ambition of its once widely admired top executives.

The end came quickly because Enron had overextended itself—and because investors and customers lost faith in its secretive and complex financial maneuvers. With legions of traders working out of a Houston skyscraper, the company put together trades so exotic that they mystified many Wall Street veterans. Under Chairman Kenneth L. Lay—who pressed the Administration to embrace a controversial policy of electricity deregulation—and former CEO Jeffrey K. Skilling, Enron had become largely a trading operation, dubbed by some the Goldman, Sachs & Co. of the energy business.

Enron's success depended on main-

taining the trust of customers that it would make good on its dealings in the market. But that trust evaporated in recent weeks as it shocked the market with changes to its nearly incomprehensible financial statements. "If you are running a trading operation, you have to be like Caesar's wife, beyond reproach. Unfortunately, the company didn't realize it," says a senior Enron employee who asked not to be identified. Today, the company seems unsalvageable. "Bankruptcy is a foregone conclusion at this point," says analyst Andre Meade of Commerzbank. Enron did not return calls seeking comment.

The fall of Enron—to 61¢ a share on Nov. 28—has already wiped out more than 99% of its stock-market value. Some \$3.5 billion of its bonds are trading at just a quarter of their face value.

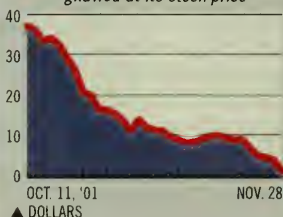
Banks that lent billions to Enron will have to fight for a share in bankruptcy court. Enron's biggest lenders are J.P. Morgan Chase & Co. and Citigroup, which together have an estimated \$1.6 billion in exposure. Of that, \$900 million is unsecured, according to sources. Other losers: Enron's customers, who traded everything

from electricity, gas, and metals to telecom bandwidth, credit insurance, and weather derivatives.

Already the once-arrogant Enron has become vulture meat. In addition to clamoring creditors, it faces class actions by shareholders and employees, whose pensions were heavily invested in Enron stock. That raises questions about how much value is left in the company, which will probably be dismembered and sold

DOWNHILL ALL THE WAY

Doubts about Enron's future have gnawed at its stock price



Data: Bloomberg Financial Markets



CHAIRMAN LAY: TOO LATE TO ENGINEER A SOFT LANDING

"If you are running a trading operation, you have to be like Caesar's wife, beyond reproach."

LEFT HOLDING THE BAG

Estimated losses or exposure of Enron's shareholders, lenders, and trading counterparties at the market close on Nov. 28

SHAREHOLDERS

Loss since Enron's 52-week high on Dec. 28, 2000:

\$63 Billion

Loss since Nov. 9
Dynege deal announcement:

\$6 Billion

TOP FIVE SHAREHOLDERS*

Alliance Capital Management, Janus Capital, Putnam Investment Management, Barclays Bank, Fidelity Management

BONDHOLDERS

Loss on bonds with \$3.5 billion face value:

\$2.6 Billion

TOP FIVE BONDHOLDERS

GE Financial Assurance Holdings, Prudential Global Asset Management, Washington State Investment Board, Wellington Management Company, ING Investment Management

BANKS

Bank debt reported on Enron's balance sheet:

\$15 Billion

BANKS WITH LARGEST EXPOSURE

Citigroup and J.P. Morgan Chase combined:	\$1.6 billion**
Bank of America:	\$200-\$300 million
Bank One:	\$100 million
Bank of New York:	\$50-\$100 million

TRADING COUNTERPARTIES

Potential losses on uncollateralized derivative contracts

\$4 Billion

*As at Sept. 1

**Unsecured debt: \$900 million

Data: Bloomberg Financial Markets; Capital Access International; Goldman, Sachs & Co.; BusinessWeek estimates

off in parts. "We will be crawling all over the carcass," looking for value in Enron's heavily discounted bonds, says David J. Winters of Mutual Series Fund Inc.

Since creditors had time to shield themselves, it doesn't appear that the implosion of Enron will drag down any other big players. "The Wall Street firms have had plenty of time to unwind whatever exposure they may have had," says Richard Strauss of Goldman Sachs. "What they may still have remaining is either collateralized or hedged." Still, there will be fallout. J.P. Morgan Chase & Co. could face a hit of 7¢ a share, while Citigroup could suffer a 6¢ hit, estimates U.S. Bancorp Piper Jaffray banking analyst Andrew Collins.

Some counterparties to Enron trades may be at greater risk—especially if they don't hold any collateral. "Everyone who has done deals with Enron has to be scrambling, because if there was any profit, they won't get it. It's a complete disaster," says Sol Waksman of Barclay Trading Group Ltd., a commodity-trading firm in Fairfield, Iowa.

Enron's fall is likely to add volatility to commodity markets. "They touch a lot of megawatts. I wouldn't be surprised if it's 25% to 30% of the national market," says Gary Ackerman of the Western Power Trading Forum. "There's a river of tears behind this thing."

"WHAT A MESS." Who's to blame? Perhaps the biggest culprit was arrogance, which has caused Enron to be compared to past self-proclaimed masters of the universe such as Drexel Burnham Lambert Inc. in the 1980s and Long-Term Capital Management in the 1990s. Many fingers are pointing at Skilling, the long-time Enron financial engineer who took over as CEO in February and then resigned with little explanation in August, shortly before the company hit the skids. "[Skilling] woke up one day and realized what a mess he created, and he showed how immature he was [by quitting]. He probably could have engineered a soft landing," says the senior Enron employee. Skilling won't comment on Enron's meltdown.

Also facing the music are Lay and Andrew S. Fastow, who was ousted as chief financial officer on Oct. 24. Fastow put together several partnerships that were intended to streamline Enron's balance sheet by taking on certain assets and liabilities. That created a conflict of interest for Fastow, who made over \$30

e Caesar's wife, beyond reproach," says an Enron exec



ENRON HEADQUARTERS: Bond dealers "will be crawling all over the carcass"

million from his partnerships. A key factor in Enron's downward spiral was the October announcement that losses from partnerships had wiped out \$1.2 billion in the equity of Enron shareholders.

On Nov. 9, it looked as if Enron's troubles were finally over. Dynegy, its smaller crosstown rival, rode to the rescue by agreeing to buy it for \$10 billion, on top of assuming its \$13 billion pile of debt. Dynegy, through its 26% owner,

ChevronTexaco Corp., also kicked in an immediate \$1.5 billion in cash to shore up Enron's balance sheet and its credit rating.

But Enron's trading and marketing business continued to deteriorate, and Dynegy started to send signals that it was losing faith. There were rumors—denied by Dynegy—that it had stopped

trading with Enron. Dynegy issued a alarmingly tepid statement of support for the deal just before Thanksgiving. Afterwards, as the stock slid, Dynegy maintained radio silence, further scarining away counterparties for Enron's crown jewel, its trading operation.

With business shrinking by the day, Standard & Poor's pulled the trigger. It lowered Enron's senior debt rating by six notches, to B-, deep in junk territory. Other credit raters quickly followed. Within hours, Dynegy announced it was abandoning the deal. "Sometimes a company's best deals are the ones they do not do," says Charles Watson, Dynegy chairman and CEO. "We knew when we say no, and this morning we said no."

The most poignant aspect of Enron's failure is the damage to its own employees. "People have had their total savings disappear," says William Miller, business manager of the International Brotherhood of Electrical Workers union local in Portland, Ore., which represents employees of Enron's Portland General Electric Co. subsidiary. "Some lives have been pretty well destroyed." Enron flew high, but when it fell, it fell hard.

By Peter Coy and Emily Thornton in New York and Stephanie Anderson Forest in Dallas, with Christopher Palmeri in Los Angeles and bureau reports

SKILLING: THE MAN WHO KNEW...HOW MUCH?

Even on his way out the door, Jeffrey K. Skilling couldn't pass up a chance to hype Enron Corp. After stunning investors and employees with his abrupt resignation as CEO on Aug. 14, he flatly denied that the announcement would damage the nation's largest energy trader: "We built a company that 10 years from now, 20 years from now, is going to be a factor to be reckoned with in the energy business," he said.

So much for Skilling's reputation as a visionary. Enron, the seventh-largest company in the U.S. by sales, is barely alive 3½ months later. As bankers, investors, employees, and trading partners scramble to salvage what they can, it's increasingly hard to believe that Skilling, 48, didn't have an inkling of the disaster that lay ahead for the powerhouse he helped create. He continues to insist that he left for personal reasons:

"Absolutely. That's the truth," he told *BusinessWeek* in a brief interview. And he won't talk about Enron's spectacular meltdown. He left the top job after six months without severance pay—which, in this day of sumptuous golden handshakes, just added to the mystery. Skilling did manage to sell Enron shares worth \$17.5 million in the first half of the year, according to Thomson Financial/First Call. During that time, the price slid 39%.

CONFLICT? Enron's collapse will only add to the pressure for Skilling to tell what he knew and when he knew it. There's no denying that he holds some responsibility for the mess. As a member of Enron's board, he supported the creation of at least some of the off-



TIMELY EXIT: Skilling's role in Enron's collapse remains an open question

balance-sheet partnerships that apparently hid Enron's debt and allowed it to overstate profits by more than \$600 million over four years. And he, along with Chairman Kenneth L. Lay, approved then-CFO Andrew S. Fastow's management of some of those partnerships, even when other executives warned of a conflict of interest.

With Skilling's unexplained departure hanging over Enron, it didn't take much to decimate investor confidence. How closely he supervised Fastow's financial footwork, or whether information was hidden from him, is not yet known. But with the Securities & Exchange Commission and lawyers in shareholder suits looking to him for answers, Skilling still has plenty of chances to come clean.

By Wendy Zellner in Dallas



CONSUMER LENDING

DO HOUSEHOLD'S NUMBERS ADD UP?

Is lender's accounting methods raise some questions

Household International Inc. has emerged as the clear winner in the battle for the wallets of the growing number of consumers who don't qualify for bank loans. With 15% of the \$600 billion market for prime borrowers, it dominates even bank players such as Citigroup's Financial. Moreover, the Prospect Heights (Ill.) company racked up third-quarter net income of \$504 million, the best in its 123-year history and a jump from a year ago.

But some critics are starting to question Household's success. The company, they say, may be headed for a fall. One raising eyebrows is that many lenders catering to a similar client base have hit the skids as the recession

and rising unemployment pressure their customers. Provident Financial Corp., a subprime credit-card issuer, reported that third-quarter profits dropped 70% as bad loans piled up. On Oct. 11, subprime auto lender AmeriCredit Corp. said that late loans had jumped 20%, sending its stock tumbling. Meanwhile, Household's delinquent loans ticked up a bit in the third quarter, but they still hover well under 5%—about half the rate of other subprime mortgage lenders.

Household is outperforming not only its troubled subprime peers but also its staid bank competitors. Its stock price has risen more than 25%, to \$60, since the beginning of 2001—handily beating the Standard & Poor's bank index, which rose just over 10% in the same

PERILOUS WATERS

A consumer group protested alleged predatory lending practices at Household in May

period. This year, banks have scurried out of Household's core business, leaving losses in their wake. Bank of America, for example, took a \$1.25 billion charge in the third quarter to shed its poorly performing auto leasing and subprime-mortgage units. Superior Bank, an Illinois thrift, failed this summer because of its exposure to subprime loans. The bailout cost the Bank Insurance Fund \$500 million.

How is Household thriving despite the tough environment? Executives attribute the company's success to strong collection practices and its long history in the business. "Investors ask us what will happen if we go through a recession," says Craig A. Stroom, vice-president. "And we can talk about how we did in the Great Depression." Then, the company's losses rose until 1932, then dropped sharply.

UNSOLICITED CALLS. One critic claims, though, that Household's performance is getting a boost from aggressive accounting. In an Oct. 18 report entitled "When the Going Gets Tough...The Accounting Department Gets Going," Ventana Capital Managing Director William Ryan says that changes in the company's accounting policies since 1996 have "obscured true earnings." Household, Ryan says, is underreporting delinquencies and losses, which will only "delay the inevitable" charges the company will have to take down the road. They are particularly worrisome now because reserves shown on Household's balance sheet fell to 3.28% of loans this year, down from 4.25% in 1997. Ryan covered finance companies for five years at Salomon Smith Barney before joining Ventana, a New York research firm, earlier this year.

Household's policies on when to declare loans delinquent or charge them off as unrecoverable appear to be more flexible than those of other lenders. The major part of the company's business is a \$44 billion mortgage portfolio. Household works hard to keep those loans from becoming two months or more late. Borrowers who are a couple of months overdue may receive an unsolicited call from a Household representative telling them that their late payments have been added to the end of their loans and that they are current again. Consumer groups, who often examine Household's high-interest-rate



AGGRESSIVE ACCOUNTING?

One analyst claims Household's policies understate losses and delinquencies. The company disagrees

HOUSEHOLD IS ACCUSED OF:

- Rolling over late loans by adding missed payments to ends of loans, thus masking delinquencies
- Delaying recognition of charge-offs to boost earnings
- Moving loans from its bank subsidiary to minimize need for reserves
- Cutting on balance sheet reserves, though its portfolio is riskier

HOUSEHOLD REPLIES:

- The practice is an industry norm, and collection rates improve after loans are "re-aged"
- Charge-off policy follows industry standards closely
- Applying bank regulatory rules would barely increase the amount of charge-offs
- Total reserves are at the highest level in company history

Data: BusinessWeek, Household International Inc.

loans for evidence of predatory lending, say they are seeing an increase in such loan management. These groups flag practices such as refinancing borrowers at higher rates. They say they were at first surprised by Household's automatic loan restructuring because it doesn't actually make the company any money—although it keeps delinquencies down. Uriah King, predatory-lending specialist for consumer advocate Miami Valley Fair Housing Center Inc., says that 10% of the Household loans he has seen in recent months have been restructured. Household says that it uses restructurings only rarely and that they increase the company's ability to collect on loans.

BIG PILEUP. Policies are at least as lenient with the company's \$13 billion unsecured-loan portfolio. Household waits 570 days, or nearly 18 months, after a payment was last made to count the loan as a loss on its books, according to Securities & Exchange Commission documents. This was changed from 300 days in 1996. Other finance-company executives say that is about twice the industry norm. Also in 1996, the company lengthened the charge-off period for its \$10.7 billion private-label credit-card portfolio

to nine months from the industry average of six months. Ventana's Ryan says this easing of standards, made when the economy was strong, could come back to haunt Household now that problem loans are sure to pile up.

Household says that its hands-on approach to dealing with borrowers is the backbone of its business model. "We get paid for being flexible in working with our borrowers," says Stroom. To keep loan losses low, the company doubled its collections staff in the past 18 months, to 5,000, he says. Collectors are paid salary plus a bonus for keeping loans current and on the books.

Household is under pressure on other

CEO ALDINGER

Household says that flexible terms for mortgage and credit customers are the backbone of its business

fronts. The California Corporation Dept. filed an \$8.5 million civil suit in November alleging that Household "engaged in willful lending violations" by charging excess fees. The company says it is reviewing the suit and has denied the allegations. At the end of October, California passed a new predatory-lending law limiting fees and types of loans that subprime lenders can make.

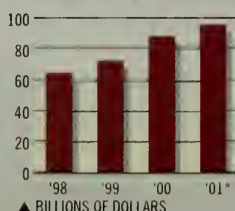
LOYAL FANS. Longtime investors in the stock say they have confidence in the company's management. Shares have quadrupled since CEO William Aldinger, a Wells Fargo & Co. veteran, joined in 1997. "It's an extremely well-run, sustainable business model," says Ken Charles Feinberg, portfolio manager with Davis Selected Advisors, which owns 13 million shares. Feinberg says that even if Household's accounting is more aggressive than that of competitors, it isn't the key to its stock performance. "Could it add a nickel [per share]? Sure," Feinberg says. "But they're due to earn more than \$4 next year."

Wall Street's major brokerages and investment banks remain fans of Household. Nineteen of the 22 firms that rate the stock list it as a "buy" or "strong buy." During the third quarter, "credit quality remained at impressive level," says a Goldman, Sachs & Co. report.

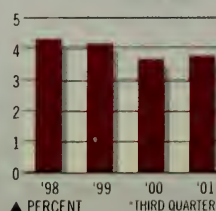
Still, Ryan isn't alone in believing that Household's \$60 share price is overblown. The company's short interest—a measure of how many investors think the company's stock will go down—jumped nearly 50% in October to over 13 million shares, or about 4% of outstanding shares. Those folks could win big if Household turns out to be anything less than the Teflon lender claims to be.

By Heather Timmons in New York

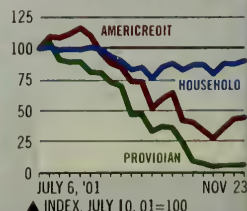
ALTHOUGH HOUSEHOLD'S LOAN BOOK HAS SURGED...



...CHARGE-OFFS ARE DOWN...



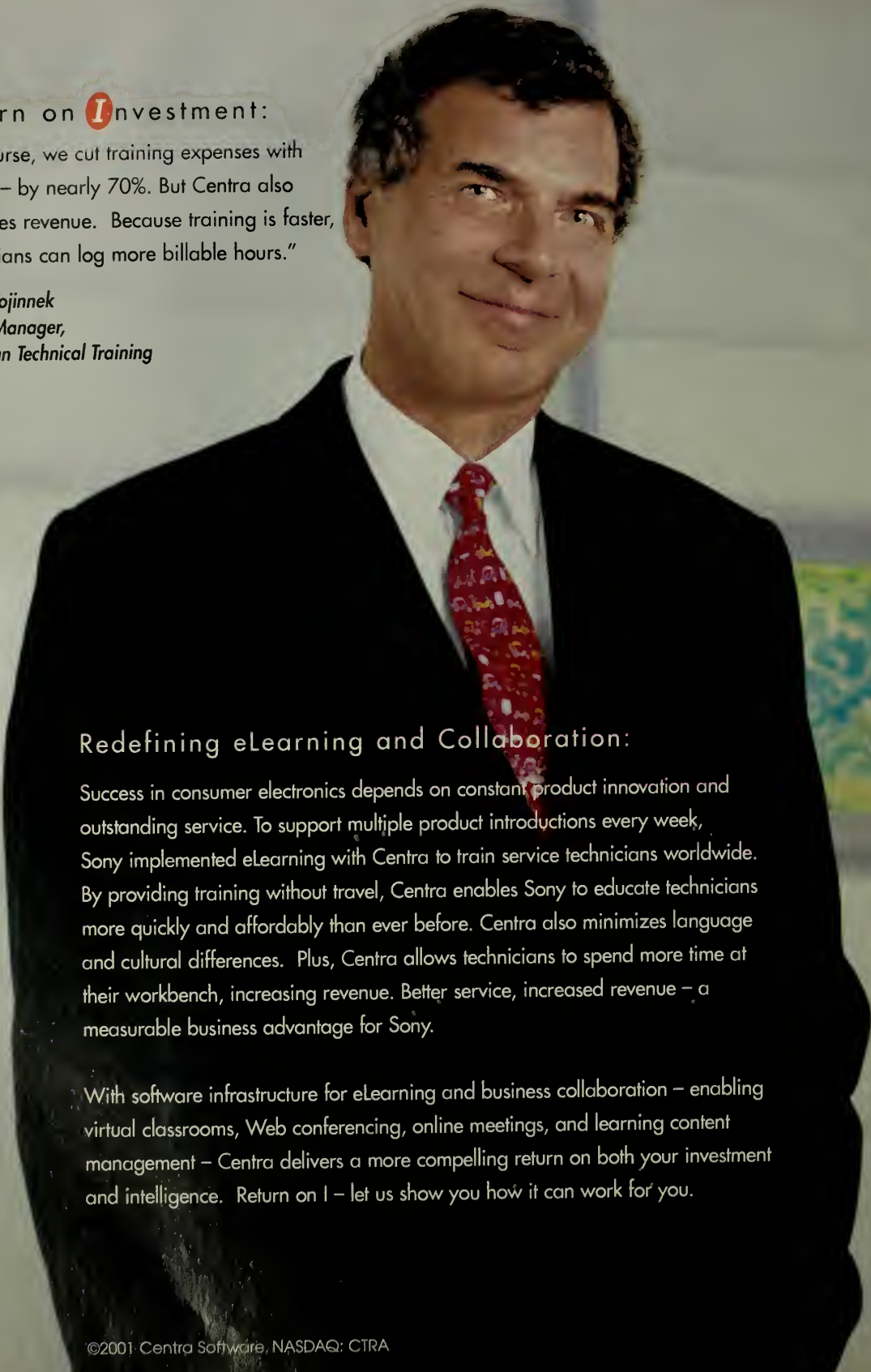
...AND THE STOCK IS STEADY



Data: Household International, Bloomberg Financial Markets

E-LEARNING AND THE EDUCATION REVOLUTION

A quiet revolution has transformed the way busy professionals around the world learn new skills critical to performing their jobs or changing careers. Internet-based learning — e-learning — has made it possible for everyone from interns to CEOs to achieve an educational aspiration. Whether you are a corporate trainer looking for a course on computer skills for your organization or an executive thinking about getting an MBA, your solution can be found on the Internet.



Return on **I**nvestment:

"Of course, we cut training expenses with Centra – by nearly 70%. But Centra also increases revenue. Because training is faster, technicians can log more billable hours."

*Peter Wojinnek
Senior Manager,
European Technical Training
Sony*

Redefining eLearning and Collaboration:

Success in consumer electronics depends on constant product innovation and outstanding service. To support multiple product introductions every week, Sony implemented eLearning with Centra to train service technicians worldwide. By providing training without travel, Centra enables Sony to educate technicians more quickly and affordably than ever before. Centra also minimizes language and cultural differences. Plus, Centra allows technicians to spend more time at their workbench, increasing revenue. Better service, increased revenue – a measurable business advantage for Sony.

With software infrastructure for eLearning and business collaboration – enabling virtual classrooms, Web conferencing, online meetings, and learning content management – Centra delivers a more compelling return on both your investment and intelligence. Return on I – let us show you how it can work for you.

A man with grey hair and a mustache, wearing a dark suit, light blue shirt, and a red tie with white polka dots, is smiling. He is standing in front of a large window that looks out onto a cityscape with greenery and buildings. The lighting is soft, coming from the window.

Return on **I**ntelligence:

"The best person to train a service representative on a new product is the product designer. With Centra, designers train service techs directly – before products come to market. It's unprecedented and possible only with Centra."

*Werner Ziemann
General Manager, Engineering,
Quality and Reliability
Sony*

Return on **I**

Centra

THE CURRENT E-LEARNING LANDSCAPE

A new world of continuing education at your finger tips.

While commonly thought of as Internet-based learning, the term e-learning also includes other electronic technologies for learning, such as audio, video, and CD-ROMs. Education analysts believe that the e-learning industry is just beginning to flower. The corporate e-learning and e-testing market is where the real growth is anticipated. Revenues are expected to hit \$23 billion by 2004, according to International Data Corp.



"Companies understand there is an economic return from making the investment," says Greg Priest, CEO of SmartForce, one of the world's largest e-learning companies. "People are a little leery and there is certainly a different sales cycle. But if there is a clear economic return — say if they are saving \$500,000 in costs — companies will still do that."

While corporate e-learning programs get the bulk of the attention, there has also been a revolution going on in the

academic classroom. Jones University, launched in 1995, was the first all-online university. "Consumers today are making choices about their education," says Dr. Pamela Pease, Jones University's president. "And E-learning is very effective and has several advantages: its flexibility and convenience, its rigorous content, and its affordable nature."

The companies profiled below are innovators on the e-learning landscape, writing e-learning software and design-

ing courses ranging from self-paced tutorials that can be downloaded and read on screen to interactive learning experiences that include online lectures and chats.

Centra: A Blending of Educational Experiences

Centra, based in Lexington, Mass., offers e-learning software that allows real-time knowledge-sharing, chats, customized courses, and the ability to add your own content across platforms into the course material.

Centra, a public company with about 260 employees, was founded in 1996 by Leon Navickas, who spent six years at Lotus with the Lotus Notes development team. Navickas figured that in the same way Lotus Notes allowed users to share documents, people should be able to share knowledge through virtual classrooms and lecture halls.

Real-Time Learning

Centra, which counts some of the world's largest companies among its clients, offers a completely integrated platform for collaborative learning through its primary product, Centra 1.

"Our software has two major components that give it the more capability than our competitors," Navickas says. "The first component is the collaborative interaction: real-time whiteboarding, content sharing, chats. The second is the knowledge repository aspect, which is really an engine for personalization. It allows you to pull the course content together with other types of content, from whatever platform you want to pull it from."

With the improvement that software like Centra 1 brings, Navickas is not surprised by Corporate America's insatiable



Memo to the industry:

Without Experience, You've Got No Business In e-Learning.

Excuse us for being brutally honest. But what would an e-Learning company that's only been around a few years know about business results? That's why there's SmartForce.

With nearly **two decades of experience** and over **\$100 million invested in our infrastructure** over the last three years alone, we've helped thousands of companies increase productivity, reduce costs, and improve customer loyalty. Using our **complete solution of content and technology**, backed by **the world's largest e-Learning services group**, companies around the world have achieved dramatic bottom line results with SmartForce.

To learn more about the e-Learning company IDC called the world's leader,* make a note of this: www.smartforce.com.

SmartForce™
Learning Solutions for
the Human Enterprise

E-LEARNING AND THE EDUCATION REVOLUTION

appetite for e-learning content. "The corporate world in the U.S. has really latched on to e-learning," says Navickas. "For customer seminars and employee training, for example, it's remarkable how much more convenient and less expensive it is. All in all, it's cheaper, better, and faster."

Centra recently joined with Mindlever, whose products will allow Centra's customers to better organize the content and store customized courses. This will have huge benefits for these companies, as

"Let's go to the database."

Navickas is also a firm believer in the "blended" learning experience, which combines Centra's real-time learning philosophy with the more common self-paced e-learning tools, in which a user downloads course material and does the work on his or her own schedule.

"Through our seamless technology, self-paced learning and online learning can be done interchangeably," Navickas says. "We're really the only vendor on the

"Through our seamless technology, self-paced learning and online learning can be done interchangeably".

—CENTRA FOUNDER LEON NAVICKAS

courses won't have to keep being redesigned, and specific pieces of any course can be retrieved and used for training new employees, for example. The Mindlever partnership will also let companies better catalogue courses and track which employees have taken which course.

"Now, our virtual live courses can be recorded and tracked," Navickas says. "If a company wants to see if someone has taken a certain course, they can just say

market whose technology supports the blended learning experience."

Centra has formed strategic partnerships with Cisco, Microsoft, Oracle, and Price Waterhouse, among others. But it's not solely corporate clients that use Centra's technology, however. The International Association of Physicians and AIDS caregivers (IAPAC) uses Centra's products to enable doctors in South Africa and other sub-Saharan countries to participate in real-time, interactive meetings with lead-

ing AIDS practitioners around the world, giving them access to the current thinking on best treatment practices.

SmartForce: Leading the Second Wave of E-Learning

A few years ago, e-learning had plenty of doubters. Educators and corporate managers were skeptical that students and employees could learn skills and process information without the guidance of a human instructor.

According to SmartForce CEO Greg Priest, today those doubts are gone. Instead, the new challenge of e-learning professionals is providing different types of companies the right e-learning products for their employees.

Info On Demand

"The issue used to be, 'Can this be done? Can people be trained via their desktops?'" says Priest, the CEO of SmartForce since 1998. "Now everyone recognizes that the answer is yes, technology can be used to educate. What is driving the e-learning industry now is bringing other components into it. Where our company is really targeting our efforts getting the right information to the right person at the right time, so they can do their job more effectively," Priest says.

It's not surprising that Priest has strong ideas about the evolution of the e-learning industry. SmartForce was an early pioneer in e-learning, and became the leader in providing information technology training. Now, Priest has SmartForce focusing on educational needs across organizations, not just in the IT area.

"Our philosophy, isn't just, 'Oh, you should buy this learning management system from SmartForce because it does such and such,'" Priest says. "We are dealing with how to help companies solve the business issues around learning."

Despite his company's success, Priest still sees a clear need for human instructors. "Right now, 80 percent of corporate training is still done by instructors," P





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says. "Companies shouldn't be doing that, but they shouldn't be doing zero either. The trick is to use instructors in those types of environments in which students will get a tremendous value out of it."

Information Experts: Evaluating Clients' Learning Environment

At Information Experts, President Marissa Levin believes that instructional designers are the unsung heroes of e-education. Information Experts, which has about 80 employees, is staffed with a core of 15 experienced instructional designers who go into clients, do interviews with leaders at the company, and then design appropriate e-courses for employees.

"An instructional designer has to go in and diagnose a client's learning environment," Levin says. "The need to be motivated to get good information from a client, because it's easy to meet resistance. Subject matter experts at a client don't typically have a lot of extra time for us."

It takes a lot more than instructional designers to deliver a course from conception to the finished course, however. Information Experts' three separate divisions all work to bring courses to life: cre-

ator the three critical aspects of e-learning: content, design, and technology.

The Medium and the Message

"If you have really good content, and no design, your message is going to get lost," Levin says. "If the information is not structurally sound, it's going to be obvious to the client. And the technology has meet the client's browser requirements and database integration requirements."

Information Experts had made major inroads in the telecommunications sector. Their telecom clients include Cisco Systems, Nortel Networks, SAVVIS, Cable & Wireless, UUNET, WorldCom, GlobalOne, Velocita, and Nextel. Other clients include Mercedes-Benz, General Motors, Thompson Financial Group, and K12, Inc.

Learning Around the World With Tata Interactive

Tata Interactive Systems (TIS), based in India, is one of the world's largest e-learning customized software developers. A subsidiary of the Tata Group, India's largest industrial group, TIS was started in 1990 by Sanjaya Sharma, who had already been at Tata for 10 years. TIS has been a success story for some time; even when Sharma operated the company out

of his one-bedroom flat, the company turned a profit. TIS officially became part of Tata Group in 1993.

TIS, based in Mumbai, India, has over 300 employees. In the U.K., TIS counts among its clients Unilever, Barclays, Abbey, Alfa Laval, BBC, Granada, BP, BT, BG, and Consignia (the British Post Office). In the U.S., TIS works with, among others, AIG, AMR, Qwest, McGraw-Hill, Pearson, Quisic, and Riverdeep. How does an e-learning company based in India serve a wide variety of U.S.- and U.K.-based companies?

"For one, we keep abreast of the latest trends in our clients' industries," Sharma says. "Also, we do studies for each client; we talk to our clients informally, and also use structured questionnaires. We also have senior, experienced production people in the U.S. and U.K. to ensure that we really understand their needs."

Adherence to strict quality standards is also extremely critical for a company based in the subcontinent to compete with Western companies. "A lot of time we hear, 'You're in India, let's see your quality standards for production processes,'" says Manoj Kutty, TIS' director of marketing. "We were one of the first Indian companies to gain ISO 9001 certification and we are also certified at SEI-CMM Level 5, which is a Carnegie-Mellon certification for companies with the most mature business processes."

Growth Potential

At McGraw-Hill, TIS created a learning network that spans across the worldwide operations of the publishing giant. "The McGraw-Hill Learning Network is the world's largest learning network and has been created by TIS, working with McGraw-Hill, in record time," says Sharma.

Despite the current economic slowdown, Sharma expects e-learning to continue to gain adherents all over the world, from India to the U.S. "E-learning is going to continue happening at a rapid pace, on all fronts: home, school, college, and the workplace," Sharma says.

Earning and Learning" with Monster.com

So what's the best way to find e-learning courses and programs around the country, or any career-building course for that matter? Well, Monster.com recently launched MonsterLearning, a business unit devoted to e-learning. In September, MonsterLearning launched MonsterLearning Search, a search engine that leads users over 30,000 catalogued courses, most of which are geared toward enhancing skills that can lead to career advancement.

"Earning and learning go hand-in-hand," says Linda Natansohn, senior

vice president at MonsterLearning. "Since Monster is geared toward careers, we want to direct people to learning experience that are going to get them where they want to go in their careers."

"We want to supply all the tools to help people advance in their careers, and today that means broader support than just finding jobs". — LINDA NATANSOHN, MONSTERLEARNING

MonsterLearning Search includes both online and instructor-led courses, as well as the full gamut of degree programs (such as MBAs), certification courses for industries like information technology, test preparation courses, and non-degree courses.

"The idea is to help consumers and providers find each other," Natansohn says. "During a challenging economy, people often find that many things happening at their company are out of

their control. But people find that they can take their education into their own hands. Now is a great time to do that."

For many people, building new skills isn't a dream or a luxury, but a necessity. According to Natansohn, 65 percent

of today's jobs require "higher skills" that require specific training, and then need to be reinforced through continuing education.

"We want to supply all the tools to help people advance in their careers," says Natansohn. "And today that means broader support than just finding jobs. Managing the search is just the first part. In the knowledge economy it's important for people to get the right skills and the right knowledge." ■

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When the Old Age Home Is Your Own

New possibilities are emerging for seniors to stay put

BY ELLEN HOFFMAN

Most Americans, the assumption goes, plan to spend their golden years in some kind of retirement community. The reality is quite different. A majority, whether out of desire or need, expect to "age in place," growing old right in the homes where they now live. A study last year by AARP, a Washington (D.C.) association that focuses on issues affecting

older Americans, found that 73% of Americans aged 55 and older "expect to always live in current residence."

That means many communities must gear up to provide essential, affordable services—visiting nurses to transportation—so seniors stay put without compromising their health or safety. They can take their cues from several models that have evolved to address issues by what's called a naturally occurring re-

NEW YORK CITY: "I just love it here," says Gold, 80

ment community (NORC). In short, that's a neighborhood not originally planned for seniors

but where most of the residents have grown old.

The programs range from wholly private efforts started by residents to large-scale initiatives such as the "social HMO," a part of the Medicare program that provides social as well as medical services.

Perhaps the most ambitious model is a pilot in Howard County, Md., aimed at coordinating both private and public agencies to provide comprehensive aging-in-place programs for the whole county.

Aging-in-place services vary, but what all these programs offer seniors is access to a staff of health and social-service professionals who can assist them in getting medical and other help, whether that means home repairs or home nursing care. Often, residents or members pay monthly or annual fees that go to support the staff. Members are charged for individual services, such as housekeeping, but often at below-market rates.

The model with potentially the broadest impact is the social HMO. A form of Medicare, it arranges for such services as housekeeping and home-delivered meals as well as medical care. Four plans are in place, covering Los Angeles and nearby counties, Las Vegas and southern Nevada, Portland, Ore., and Brooklyn, N.Y. All in all, more than 100,000 people are enrolled.

Next year, New York's social HMO, Eldercare, will be opened to residents of Queens and Manhattan. Meanwhile, a bill pending in Congress would expand the plans to other areas.

COUNTS. If you're 65 and you live in one of four areas with a social HMO, you can opt to it when you apply for Medicare. Kenneth and Sylvia Williamson of Long Beach, Calif., decided to join the 51,000-member Senior Care Network (SCAN), the social HMO in the Los Angeles area, even though they don't need aging-in-place services just now. The Williamsons are planning ahead: "I've been pretentious in the business world, but when it comes to investing, I wasn't that shrewd," says Kenneth, 72. "So I don't have a big war chest to throw" for intensive in-home help.

Could Kenneth or Sylvia, 68, develop a chronic illness or become frail, SCAN would assign a personal care planner to arrange for medical, and in-home services. To make use of a plan under the plan, a member would have to get the approval of a case manager. While the services aren't free, they're less expensive than if they were to get them on your own. For instance, the co-payment for a home-delivered meal is \$2, according to SCAN's 2002 fee schedule;

it's \$8.50 per visit for transportation to medical or dental appointments, housekeeping services, and help with bathing and dressing.

At the other end of the spectrum from social HMOs are the homegrown networks created by residents who saw a need as they and their neighbors grew older. Heritage Harbor Health Group in Annapolis, Md., is a nonprofit run by some 1,400 members who live in a suburban community of single-family homes, townhouses, and high-rise apartments. The \$85 annual membership fee, plus charitable contributions, support an administrative staff and several nurses.

The group guarantees free access to a nurse 24 hours a day, seven days a week. Residents can get their blood pressure checked and receive health screenings as well as get assistance in finding other services.

In the town of Northport and surrounding Leelanau County in Michigan, older residents depend on ShareCare for services such as those of Heritage Harbor. Members, who number about 400, pay a one-time \$75 fee and annual dues

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Social HMOs arrange for housekeeping and home-delivered meals as well as medical care. A bill in Congress would bring them to more areas



LONG BEACH, CALIF.: In joining a social HMO, the Williamsons are planning ahead

that range from \$50 to \$150 per year depending on their age. In addition, about 100 members serve as volunteers, doing such tasks as driving other members to medical appointments.

Another aging-in-place approach combines private funding with city and state subsidies. In New York City's Chelsea neighborhood, Penn South, a 10-building apartment complex with some 6,000 residents, boasts an in-house staff of nine health and social-service professionals to serve its growing senior population. They provide such services as advice on medications, blood-pressure monitoring, and diabetes screenings. Penn South also has an adult day-care center. The costs of such services are paid by rent and by state and city subsidies. United Hospital

Combining private funds with city and state subsidies, one New York apartment complex has an in-house staff of nine health and social-service professionals

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Fund, a nonprofit that focuses on health issues, started the project in the 1980s because "we were seeing a lot of visits to the emergency room [by Penn South residents], and they looked preventable," says Fredda Vladeck, director of UHF's aging-in-place initiative. Now, New York State has 27 other similar projects.

Goldie Gold, 80, is a beneficiary of Penn South's program. She and her husband, Julius, 86, have lived in the complex since 1967 and have never considered moving. "When the weather is nice, I can sit in the little garden outside the building and chat with my friends. I just love it here," she says. When Julius, a diabetic, had gangrene in his leg, the on-site social worker arranged for a visiting nurse. Now that he has Alzheimer's, Goldie is thankful that he goes to the adult day-care program two days a week.

Just as Penn South has made aging-in-place services part of its range of perks, Maryland's Howard County is studying how aging-in-place can be an integral benefit of living in the county. Located south of Baltimore, Howard County ex-

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FIRSTGOV

www.seniors.gov

Seniorresource.com

www.seniorresource.com/ageinpl.htm

United Hospital Fund of New York

212 494-0758

SOCIAL HMOS

Elderplan, New York City

www.elderplan.org, 718 921-7898

SCAN Health Plan,

Southern California

www.scanhealthplan.com,

800 247-5091

Senior Advantage II, Portland, Ore.,

and Clark County (Wash.) area

503 813-2000

Senior Dimensions, Las Vegas

www.seniordimensions.com

pects the number of residents aged 60 and older to jump 260% in the next 20 years, 72,000, or 23% of Howard County's population.

Working with Horizon Foundation, a Columbia (Md.) nonprofit that has committed \$600,000, the county has launched a pilot program that initially focuses on low-income seniors. It provides home visits by professionals to assess seniors' physical and mental health and connect them to medical and social services. They also arrange for home remodeling such as building ramps, wheelchairs, and, in some cases, curb-to-curb transportation. Eventually, says Richard Krieg, the foundation's president, the county plans to have a high-tech medical-information and alert system so that a senior's health record is immediately available when an emergency call is made.

The number of aging-in-place programs remains tiny compared with the potential need as baby boomers retire. But the options are growing as more public and private groups experiment with ways to enable people to grow old in their homes—safely.

MAKING A HOUSE SAFE FOR SENIORS

BY ELLEN HOFFMAN

The Magsamens—O'Linda, 61, and Ben, 69—love the three-story cliffside home they built 24 years ago outside Fort Collins, Colo. They never want to leave it.

With that in mind, they're doing extensive remodeling to ensure that their home remains hospitable even when they become frail. The Magsamens are building a two-story "seamless" addition comprising a garage and a suite on top with a bedroom, office, bathroom, and mini-kitchen. That will let the couple live all on one floor, using the garage-top suite and the dining and living room of the existing house. To bypass the 52 steps leading to their front door, they're installing an elevator in the garage.

With more Americans nearing their retirement years, many want to retrofit their homes so they can grow old in them comfortably and safely. Fortunately, you can do this without spending a ton of money—or giving your house a nursing-home look.

Some alterations are critical for safety. Grab bars in the bathroom—

and not only by the bathtub and shower area—"is just common sense," says Jon Pynoos, professor of gerontology at the University of Southern California in Los Angeles. Other simple improvements include handheld showers and nonslip strips on the shower or tub floor.

Other design features prevent accidents by limiting the reaching you do to perform routine tasks. Baltimore architect Tim Elliott suggests lowering at least one counter so you can prepare food while sitting down. Look for a stove top with controls on the front so you don't have to reach across burners. A side-by-side refrigerator-freezer lets you get into the freezer more easily, while shelves that roll out of cabinets make heavy pots more accessible.

A well-lit space can ease everyday tasks and prevent falls. Think about using light fixtures with dimmers and mounting them on walls overhead to reduce the risk of tripping over wires. The best strategy when retrofitting a home is to think of ways to make it comfortable for everyone. After all, even your grandchild can benefit from the removal of electrical cords he or she might trip over.



A Paycheck in the Mail Every Month

For lifetime income, seniors should look at annuities

ROL MARIE
OPPER

How does a monthly check for life sound to you? To many retirees, caught between a roller-coaster stock market and shriveling interest rates, it sounds like security. A lifelong payout is the promise of an immediate—or income—annuity, and more Americans are buying them. Last year, \$3.8 billion of these annuities were sold, and sales jumped 30% in the first half of 2001.

Unlike deferred annuities, which people use to save for retirement, income annuities are for parceling out money already accumulated. Purchasers turn over part of their savings to an insurance company in return for a monthly check. Because interest rates are low, payouts are not high. Still, at a time when surviving to 90 is not unusual and living to 100 is a possibility, this guarantee has its appeal.

Retirees once relied on company pensions for lifelong income, but fewer firms now offer them. They're moving to 401(k) plans, which have no guarantees. "This is the only thing that can bring lifetime income other than a pension or Social Security," says Farrell Dolan, an executive at Fidelity Investments Life Insurance.

Income annuities come in two flavors—fixed and variable. The fixed annuity guarantees a set monthly, quarterly, or annual sum. Put in \$100,000 now, and if you're a 70-year-old man, you'll get about \$887 a month for life, according to

WebAnnuities.com, which tracks average payouts. Remember, part of that money is your own principal, since you don't get it back at the end. Studies have shown fixed annuities pay somewhat less than Treasury bonds for the average purchaser—less if you die young, more if you live long. Think of them as insurance as much as an investment.

CHOICES. A variable annuity lets you choose stock, bond, and money-market funds in which to invest your stake. Its selling point is that it can help you keep up with inflation. (One company, TIAA-CREF, will soon give the option of an inflation-linked bond fund.) But anyone who has watched the stock market lately knows you can lose money, too, so your payout can fall. Some variable annuities offer a minimum payout. Or you could create your own floor by splitting the money between fixed and variable plans. Also, with a variable annuity, you need to compare investment fees as well as sales charges. With fixed annuities, payouts are net of fees.

After you decide which you want, lots of choices remain. You can buy an annuity that pays only during your lifetime or one that continues until the death of the surviving spouse. You can opt for a feature that guarantees checks for at least 5, 10, 15, even 20 years, regardless of how long you live. This prevents the scenario in which you

buy an annuity one day and die the next—and the company keeps it all. With a guaranteed period, your heirs collect the remainder. This protection comes at a price: the 70-year-old above would get only \$700 with 20 years certain.

Investors deciding how much of their living expenses to cover with an annuity face a major hurdle: inflation. Unlike Social Security, annuities almost never adjust for it. A \$1,000 monthly payment will feel like \$412 in 30 years if inflation runs at a 3% annual rate, warns Shane Chalke, CEO of AnnuityNet, one company offering an inflation-adjusted annuity. Initial payments are lower, but grow with inflation.

If you have more than \$2 million in assets, you're unlikely to outlive your money and may not need an income annuity. If you're in poor health, this insurance against long life might not be advisable. Hearty retirees who want this protection should shop around. Payouts can vary by 15% or more for the same product, says Joe Rosanswank, editor of *Comparative Annuity Reports*. And be sure to buy from a company with a top credit rating from Moody's, Standard & Poor's or A.M. Best. One last caveat: Because interest rates have dropped, you'll lock in lower payments if you buy today. One way around this is to put part of your money in now, then buy another annuity if rates move higher.

With income annuities, you won't get rich. But at least you won't die penniless.



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Payouts on Income Annuities

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with 10-year guarantee	817.55	70 with 10-year guarantee	769.60
with 65-year-old spouse	647.56	70 with 75-year-old spouse	711.30

*Payouts are the average paid by 16 leading annuity companies as of Nov. 27

Data: WebAnnuities.com

Work Still Does a Body Good

If playing golf just isn't enough, get a job

BY ANNE FIELD

Sometimes, retirement doesn't look like retirement. Five years ago, Howard Parker left the architectural firm he co-founded in 1961, aiming to become more involved in community activities. Today, Parker, 72, heads a committee of about 16 younger members of the American Institute of Architects' Dallas chapter, focusing on improving conditions in a densely populated, low-income neighborhood. "It has been a very rewarding experience," Parker says. "Because I'm an architect, I see many opportunities to use my skills."

Parker is typical of a new breed of retiree—the kind who doesn't stop working. Thanks to increasing longevity and better health, older people are more active than ever. For many, that means continuing to use the skills they've honed over long, productive careers.

Some are paid: Almost 13% of the labor force consisted of people age 65 and older in 2000, up from 10.8% in 1985, says the U.S. Bureau of Labor Statistics. Still, most volunteer.

Indeed, money is seldom the main motivator. Some 90% of retirees work primarily to keep active rather than to earn income, according to a recent Cornell University study. "Most people go back to work for the social interaction and to feel productive," says Bill Coleman, senior vice-president for compensation at Salary.com, a Wellesley (Mass.) company that publishes information about compensation.

Staying mentally as well as physically active in later years can also keep you younger. "When you continue to do new things, you're making new connections in your brain and keeping it more dynamic," says Dr. Guy McKhann, professor of neurology and neuroscience at Johns Hopkins University School of Medicine. Recent studies have shown a relationship between sustained mental activity and delayed onset of Alzheimer's disease.

If you're willing to donate your services, the choices are great. Opportunities exist in everything from professional associations and university-run programs to nonprofits and government-

sponsored agencies. Since it's hard to know where to start, you should first decide what it is you hope to gain. Do you want to work with others in your profession? Do you want to teach? Do you want to be involved in social issues you feel strongly about?

Charles Killian, 72, is a case in point. He retired nine years ago as environmental control director and manager of external affairs at Boston-based DuPont NEN Research Products, which makes radioactive chemicals for scientists. One of his many functions had been to train employees, police, and firefighters in handling radioactive material.

Looking to use his knowledge and skills as a scientist and trainer, he applied to RE-SEED, a volunteer program at Northeastern University that places retired scientists and mathematicians in middle schools to help teachers. After 65 hours of training, Killian now teaches three sixth-grade science classes one day a week at Martin Luther King Jr. Middle School in Dorchester, Mass. "I get a lot of enjoyment out of working with these kids," says Killian, who also trains new RE-SEED recruits.

The chance to be around young people is a big draw for many retirees.

ELDERCARE

That's part of the rationale for a new program at the Institute for Creative Aging at William Paterson University in Wayne, N.J. The institute's Student Life program assigns 24 older adults as mentors to undergraduate and graduate students. Volunteers combine their professional skills with counseling and emotional support. One 80-year-old retired speech teacher helped a football player about to fail a public speaking course—and thrown off the team. After four sessions with a mentor, the student was able to pass the course. **TROUBLESHOOTERS.** Another avenue is to come involved in a professional association nonprofit. Like Howard Parker, you can stay close to your specific area of expertise. Or you can draw on the business knowledge you developed through your career.

When 70-year-old Jim Sugrue retired six years ago as a human-resources manager with UPS Parcel Service, he threw himself into volunteer work at the Highbridge Community Life Center in the Bronx (N.Y.). His work at the center, which provides adult education, counseling and other services to residents of the low-income area—has little to do with human resources. However, he and fellow UPS retiree

Staying mentally and physically active in later years can keep you younger. Recent



Finding Work for Pay

People over 65 are motivated to work more by the desire to stay productive than to make money. But for those looking to sell their skills, here's some advice from employment experts.

■ **THINK PART-TIME** That might mean working as a consultant while a hiring freeze is on, filling in for a military reservist called to duty, or supervising a short-term project. Check with former employers or their competitors.

■ **CONTACT JOB ADVISERS** Look especially to employment agencies and consulting firms that specialize in interim executive work.

■ **DON'T APPEAR SET IN YOUR WAYS** Focus on anything you've done recently that demonstrates your ability to adapt to changing times.

■ **BE FLEXIBLE** Show you're willing to take short-term assignments someone else might not want.

■ **POSITION YOURSELF AS A TROUBLESHOOTER** You don't have as much to lose, so you can take on the role of tough guy and force unpopular changes.

■ **REDUCE EARNINGS EXPECTATIONS** Make the point that you don't need the salary or benefits younger workers require.

THE 'HOOD: McEwen, 68, helped the group apply for foundation funding and set up an internship program for law students with their alma mater, Fordham University. "I'm making use of all my management skills," he says. "I was trained to define a problem and fix it, and that's what I do here." Government-funded programs also offer a wealth of opportunities. The National Service Corps' Retired & Senior Volunteer Program places people in 1,300 programs nationwide, based on their expertise and interests. A grandparent of government programs is the Service Corps of Retired Executives (SCORE). Created in 1964, it deploys volunteers to act as mentors to entrepreneurs, counseling them on everything from how to write a business plan to how to get funding.

McEwen, 68, former director of management information systems for Bechtel, started volunteering at the SCORE chapter in San Jose, Calif., six years ago. Now he's also district director for the Silicon Valley chapter, which in-

cludes San Jose, San Francisco, and Oakland. His counseling ranges from one-shot advice sessions to long-term relationships where, he says, "it's almost like being at work again." For a year and a half, Jensen worked with a struggling business to help update its information-processing system, interviewing employees, taking an inventory of equipment, and putting together a new system with donations from Hewlett-Packard and Microsoft.

Jensen also volunteers with the Software Development Forum, another group that advises would-be entrepreneurs. That's not unusual. Retired executives often lend their services to more than one organization.

Take Charles Killian, who is chairman of the Governor's Advisory Council on Radiation Protection, a member of the Massachusetts Nuclear Incident Advisory Emergency Response team, and an adviser to Newmarket Business, which counsels small-business owners. "My first year of retirement, I played a lot of golf," he says. "But I don't have time for that anymore." Maybe next time Killian retires, he will. ■

ent that sustained mental activity may delay the onset of Alzheimer's

WEIGHT WATCHERS: A LITTLE DEBT-HEAVY?



BY ROBERT BARKER

rb@businessweek.com

This is a well-known brand with a smart business plan—but the market seems to be missing the company's weak capital structure

Weight Watchers International went public just as the nation started its pig-out season. Stroke of genius or mere coincidence? I don't know, but investors are gobbling up the stock. From a Nov. 14 initial public offering at \$24 a share, Weight Watchers added 23% its first trading day and kept gaining. The stock recently traded above \$32 (chart).

In this post-Net Mania era, Weight Watchers' allure doesn't stop at the instant comprehensibility of its business plan (more fat people means more profit). Brightened by spokeswoman Sarah Ferguson, Duchess of York, the Weight Watchers brand attracts more than \$1.5 billion in global sales. Unlike so many Net-era IPOs, Weight Watchers has let public investors in on an indisputably thriving business, with a long record of profits. After inspecting its financials, though, you may think twice before betting its stock will fatten your portfolio.

Founded in 1961 by a trio of New York City dieters, Weight Watchers was bought in 1978 by H.J. Heinz. The food giant eventually tainted the franchise by peddling prepackaged meals to dues-paying members at the company's signature weight-loss classes. In September, 1999, Heinz sold control to a private Luxembourg firm, Artal Group, which did a 1980s-style leveraged buyout: Artal bought from Heinz 94% of Weight Watchers' equity. In return, Heinz got preferred stock and cash, most of it borrowed by Weight Watchers itself. New managers put up \$4 million to close a deal valuing Weight Watchers at \$735 million. Two years later, the stock market values the company at \$3.4 billion.

EASY MONEY. One reason may be that investors are focusing on the \$1.5 billion in retail sales brought in by the Weight Watchers brand. Yet most of that goes to franchisees and licensees, such as Heinz, which kept a perpetual, royalty-free right to use the brand for products from frozen breakfasts to pizza. Through September this year, Weight Watchers posted revenue of \$478 million and is set to collect perhaps \$600 million for the full year. That's 40% or so of what the brand generates overall.

What the market seems to be missing entirely is the company's weak capital structure. Liabilities, including \$481 million in long-term debt left from the buyout of Heinz, outstrip assets. That leaves Weight Watchers with a net worth of negative \$194 million, plus a hefty financing tab at rates of up to 13%. Interest costs and

preferred-stock dividends this year are on track to near \$60 million, or 10% of revenue.

The IPO did nothing to help lower those costs. Instead of paying off some of the debt, Artal and a few minority partners are taking all the deal's \$455 million in estimated proceeds. This means that Artal, which will continue to hold more than 76% of Weight Watchers' equity, has gotten its original investment back several times over. In other words, it's now playing with money put up by public investors in the IPO. Will that necessarily stop Weight Watchers from continuing to thrive? No, but to me it suggests that the easy money has already been made.

Public companies to compare Weight Watchers with are scarce, but you can get a rough indi-



BIG BOARD BOUNCE: The stock jumped 23% on its first

Weighty Gains



tion of values by looking at what Weight Watchers paid for a major U.S. franchisee last January: \$83.3 million, or 1.4 times revenue and 6.8 times cash flow. At \$32 a share, Weight Watchers trades at 5.6 times my estimate of this year's revenue and 40 times the \$80 million to \$85 million in net earnings it may post.

Cash flow? Through September of this year, Weight Watchers reported \$120 million in cash from operations, a huge leap over the \$50 million reported a year earlier. Weight Watchers' prospectus doesn't offer the details you need to understand how that happened. Nor did Tim Kiritsis, its chief financial officer, answer my inquiries. But guessing—generously—that the company will provide \$160 million in cash this year, the stock would be trading at 21 times cash flow. At that, chances are it is the sellers who will be pigging out this holiday season.

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Co

THE IDEAL BLEND: COMPAQ & STARBUCKS

Partnership Will Create Breakthrough Wireless Customer Experience

Compaq and Starbucks have announced a five-year strategic relationship in which Compaq was named the Seattle-based coffee company's preferred information technology infrastructure provider for its retail stores and corporate headquarters. Starbucks Coffee Company is the leading retailer, roaster and brand of specialty coffee in the world, with more than 4,800 stores worldwide and 50,000 employees. The two companies will work together to blend technology and lifestyle thereby enhancing the Starbucks coffee experience.

Starbucks locations across North America, Compaq, a worldwide leader in mobile computing devices, has been named the in-store Internet access device provider for the wireless broadband network. In the future, Starbucks customers will be able to enjoy their favorite coffee beverages while accessing broadband content and services or downloading music through innovative Compaq wireless devices such as mobile PDA's, the award-winning iPAQ Pocket PC or their own wireless-enabled devices.

"anytime/anywhere access," said Michael Capellas, Compaq's Chairman and Chief Executive Officer. "This alliance with Starbucks is strong evidence of our focus on deploying innovative products and solutions for our partners' success."

"This agreement allows us to take advantage of Compaq's incredible breadth and depth of technology and service offerings to continue to improve many aspects of our business," said Darren Huston, Senior Vice President of New Ventures at Starbucks. "Working closely with Compaq on enterprise and consumer-facing innovations will ultimately help us improve store operations and enhance the experience of our customers."



Howard Schultz, Starbucks' Chairman and CEO, said, "The alliance provides powerful IT solutions to support Starbucks' business on all levels with reliable high-performance solutions. Compaq's vision for a wireless Internet is all about delivering personalized content with Compaq will help create a high-speed computing environment for the tech-savvy, as well as the wireless technology customer in mind."

Under this agreement, Compaq will be the primary and preferred strategic provider for Starbucks' technology infrastructure. It includes, but is not limited to, enterprise-class servers, networking equipment, and other IT services. *continued on page 10*

CHECK IN, LOG ON AND SURF WITH COMPAQ AND BRITISH AIRWAYS

Compaq and BA offer wireless solutions to business travelers at JFK. Compaq has helped British Airways go wireless. Working with British Airways, Compaq has been able to provide mobile offices with relative ease. The backbone of the wireless LAN network infrastructure supported by an on-site Compaq server is available to demonstrate the capabilities of the iPAQ Pocket PC. British Airways has chosen Compaq as its preferred IT partner for its commitment to delivering the highest quality of service to its customers.

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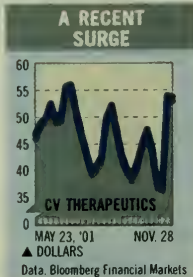
HEART-POUNDBING NEWS



GENE G. MARCIAL

Therapeutics' back on angina. It could pay off big. Si aims to be top banana in videoconferencing. Drugmaker may go for Discovery Partners

A prime example of why the biotechs are gaining favor: CV Therapeutics (CVTX). It has come out with what analysts say is the first new class of angina drug in 20 years. The remedy promises to improve the lives of 10 million Americans suffering from chronic chest pain, an estimated \$4 billion-a-year market. CV specializes in small-molecule drugs to treat cardiovascular disease. "CV aims to be the one-stop shop for cardiovascular drugs," says Dr. Mark Monane, biotech analyst at New York investment firm Needham, who rates the stock—up from 30 on Nov. 8 to 53.90 on Nov. 28—a strong buy, with a target of 72. CV's Ranolazine produced "markedly positive results" in its second Phase III clinical trials, involving 191 patients with chronic angina, says Monane. Subjects were timed to see how long they could exercise on the treadmill before having an attack. Those who took Ranolazine could exercise longer, and had one less episode of angina per week. And they felt only "small changes" in blood pressure and heart rate, says Monane. Ranolazine is also being tested for use against atrial fibrillation, congestive heart failure, and cardiac imaging.

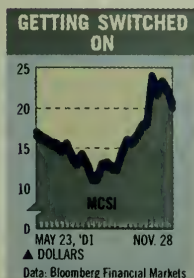


The results will enable CV to file for approval of Ranolazine as a new drug with the Food & Drug Administration in mid-2002, says Monane. He expects it to be on the market by mid-2003. As the chronic-angina market continues to expand, at 400,000 new cases a year, Ranolazine will be important, says Monane, who says the drug should produce sales of \$273 million in 2004, its first full year on the market. CV should be in the black by then, he says, earning \$2.58 a share. Morgan Stanley and Deutsche Bank also rate CV a strong buy.

AT MCSi, SCREENS ARE LIGHTING UP

When you want videoconferencing in your corporate offices, MCSi wants to be the company you call. The largest integrator of audio-visual and broadcast presentation gear, MCSi (MCSI) is becoming a top source of technical solutions for arranging long-distance meetings—at a time when corporations are cutting back on travel, for economy and safety.

With only 5% of U.S. boardrooms equipped for videoconferencing, the "longer-term prospects remain bright for MCSi, particularly as companies look for ways to reduce travel costs while maintaining or improving productivi-



ty levels," says analyst Christopher Versace of investment bank Friedman, Billings, Ramsey Group. He rates the stock, which climbed from 11 on Aug. 7 to 20 on Nov. 28, a buy.

Elliott Schlang of Lynch, Jones & Ryan says the videoconferencing business, which has picked up a lot since September 11, will add sales of \$475 million in 2001 and \$525 million in 2002. Revenues for 2001, he figures, will jump to \$948 million in 2001 and to \$990 million in 2002, from 2000's \$896 million. Earnings will rise to \$1.24 a share in 2001 and \$1.50 in 2002, up from \$1.19 in 2000, he adds. His target for the stock: 33.

MCSI Chairman Michael Peppel estimates that, by cutting companies' travel costs by 25%, videoconferencing gear could pay for itself in nine months. Among MCSi's top clients: Microsoft, Boeing, Pfizer, AOL Time Warner, and FedEx.

IS DISCOVERY ABOUT TO BE DISCOVERED?

Acting like an outsourcing company, little-known Discovery Partners International (DPII) provides critical drug-discovery services to pharmaceutical and biotech houses to speed up their own internal processes. The company has become such a crucial part of drug development that the major Wall Street firms follow the small outfit, even though its market cap is just \$109 million. High on the stock are analysts such as J.P. Morgan's Robert Olan, who rates it a strong buy, and Lehman Brothers' Joseph Dougherty, who pegs it a buy. Currently trading at 5.50 a share, Discovery develops and sells the instruments and associated products that biotechs and drug companies use to generate chemical compounds and create new drugs. Major customers include Merck, Bristol-Myers Squibb, Novartis, and Japan's Takeda Chemical.

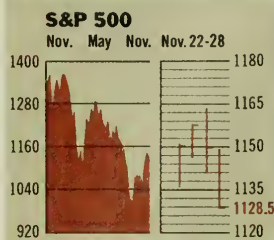
Steve Flacks, president of Flacks Investment Partners, who owns 600,000 Discovery shares, says there is another aspect to his interest: He expects a pharmaceutical house will make a run for the company, which has \$80 million in cash, or \$3.30 a share. Flack believes Discovery received an unsolicited offer earlier this year from a drugmaker when the stock was 8. Management declined to name the suitor, he says. The offer was rejected as too low, says Flack. He reckons the stock is worth 15 in a buyout. A spokeswoman says Discovery is more focused on acquiring other companies, rather than on being acquired.



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

The markets were mixed for the week ended Nov. 28: Although Nasdaq eked out a 0.7% gain, the Dow Jones Industrials and the S&P 500 fell 1.2% and 0.7%, respectively. Investors are jittery about the U.S. economy, now officially in a recession, and the release of the Federal Reserve's Beige Book on Nov. 28 suggested economic activity in October and the first half of November was soft.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Nov. 28	Week	Year to date	Last 12 months
S&P 500	1128.5	-0.7	-14.5	-15.5
Dow Jones Industrials	9711.9	-1.2	-10.0	-7.6
Nasdaq Composite	1888.0	0.7	-23.6	-31.0
S&P MidCap 400	481.0	0.6	-6.9	-2.3
S&P SmallCap 600	213.5	0.0	-2.8	5.7
Wilshire 5000	10,427.1	-0.5	-14.4	-14.5

SECTORS

	Nov. 28	Week	Year to date	Last 12 months
BusinessWeek 50*	726.9	-1.3	-25.1	-30.1
BusinessWeek Info Tech 100**	405.9	0.0	-28.2	-40.2
S&P/BARRA Growth	587.3	-0.8	-14.6	-20.4
S&P/BARRA Value	540.7	-0.7	-15.0	-11.3
S&P Energy	768.4	-1.8	-17.5	-18.3
S&P Financials	144.2	-0.4	-12.4	-2.7
S&P REIT	91.7	0.1	4.2	11.8
S&P Transportation	667.8	-0.6	-4.3	-2.6
S&P Utilities	231.6	-3.9	-33.9	-30.1
GSTI Internet	99.6	2.2	-45.2	-53.1
PSE Technology	667.5	0.9	-18.0	-21.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Conglomerates	17.1	71.9
Hotels & Motels	15.8	57.2
Office Equip. & Supplies	15.5	44.7
Department Stores	14.0	42.4
Airlines	13.4	37.8

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders			
Technology	19.0	Precious Metals	20.4
Pacific/Asia ex-Japan	14.8	Small-cap Value	15.7
Latin America	13.0	Real Estate	14.1
Diversified Emerging Mkts.	12.5	Mid-cap Value	11.1
Laggards			
Precious Metals	-2.1	Technology	-39.6
Natural Resources	-2.1	Communications	-37.4
Japan	1.9	Japan	-31.3
Utilities	1.9	Diversified Pacific/Asia	-23.6

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders			
ProFunds UltraOTC Inv.	42.2	CGM Focus	49.6
Black Oak Emerging Tech.	35.6	Boston Part. Sm. Cap Val. II	48.5
Potomac Internet Plus	34.6	Wasatch Micro Cap	48.0
iShares DJ. U.S. Internet	33.8	Matthews Korea	44.3
Laggards			
Rydex Dynamic Vent. 100	-32.2	ProFunds UltraOTC Inv.	-75.2
ProFunds UltraShort OTC	-32.2	Berkshire Focus	-71.1
Potomac Internet Short	-25.0	Berkshire Technology	-70.6
Rydex Arkots Investor	-17.5	Merrill Lynch Focus 20 B	-69.9

Data: Standard & Poor's

GLOBAL MARKETS

	Nov. 28	Week	Year to date
S&P Euro Plus (U.S. Dollar)	1039.0	-1.4	-27.1
London (FT-SE 100)	5205.2	-2.0	-16.1
Paris (CAC 40)	4445.5	-2.4	-25.1
Frankfurt (DAX)	4916.0	-3.4	-23.1
Tokyo (NIKKEI 225)	10,624.8	-0.3	-22.1
Hong Kong (Hang Seng)	11,066.2	-1.0	-26.1
Toronto (TSE 300)	7358.2	0.4	-17.1
Mexico City (IPC)	5848.2	3.1	3.1

FUNDAMENTALS

	Nov. 27	Wk. ago
S&P 500 Dividend Yield	1.36%	1.38%
S&P 500 P/E Ratio (Trailing 12 mos.)	46.3	46.0
S&P 500 P/E Ratio (Next 12 mos.)*	22.0	21.9
First Call Earnings Revision*	-2.45%	-3.94%

*First Call Corp.

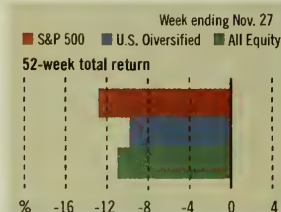
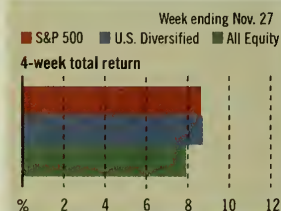
TECHNICAL INDICATORS

	Nov. 27	Wk. ago
S&P 500 200-day average	1181.9	1186.0
Stocks above 200-day average	49.0%	47.0%
Options: Put/call ratio	0.64	0.59
Insiders: Vickers Sell/buy ratio	1.06	1.01

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Natural Gas	-18.0	Communications Equip.
Engineering & Constr.	-15.0	Natural Gas
Oil-Well Equip. & Svcs.	-14.1	Instrumentation
Oil & Gas Drilling	-13.8	Computer Systems
Oil Exploration & Prod.	-11.6	Defense Electronics

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES

	Nov. 28	Week ago
MONEY MARKET FUNDS		
	2.18%	2.26%
90-DAY TREASURY BILLS		
	1.83	1.94
2-YEAR TREASURY NOTES		
	3.05	3.08
10-YEAR TREASURY NOTES		
	4.92	4.96
30-YEAR TREASURY BONDS		
	5.35	5.35
30-YEAR FIXED MORTGAGE†		
	7.01	6.81

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	
	4.19%
TAXABLE EQUIVALENT	
	6.07
INSURED REVENUE BONDS	
	4.41
TAXABLE EQUIVALENT	
	6.39

THE WEEK AHEAD

PERSONAL INCOME Monday, Dec. 3, 8:30 a.m. EST ► Personal income probably grew 0.1% in October. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. October consumer spending likely rose 2.1%, after falling 1.8% in September.

CONSTRUCTION SPENDING Monday, Dec. 3, 10 a.m. EST ► Building outlays are projected to have fallen for a sixth consecutive month, by 0.3% in October.

PURCHASING MANAGERS' INDEX Monday, Dec. 3, 10 a.m. EST ► The National Association of Purchasing Management's index of industrial activity probably rebounded to 42% in November, after tumbling to 39.8% in October.

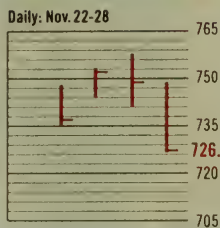
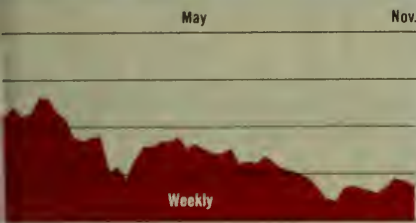
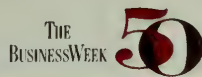
FACTORY INVENTORIES Friday, Dec. 7, 10 a.m. EST ► Manufacturing inventories likely fell 1% in October.

EMPLOYMENT Friday, Dec. 7, 8:30 a.m. EST ► Nonfarm payrolls are projected to have

fallen by 200,000 jobs in November after a decline of 415,000 jobs in October. November factory payrolls likely fell by 85,000 jobs. The cuts will push the unemployment rate to 5.5%, while the average workweek is forecast to remain unchanged, at 43.0 hours.

INSTALLMENT CREDIT Friday, Dec. 7, 10 a.m. EST ► Consumers probably took on a lot of additional debt during October after adding \$3.2 billion of new credit in September.

BusinessWeek Fifty



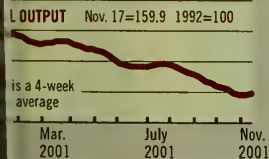
declined 1.3% for the week. Leading the decline were such energy stocks as Calpine, off 13.7%, and n 9.5%. Energy companies fell sharply in the wake of the collapse of Dynegy's deal to acquire En- to the weakness in the BW 50 were the brokerages Lehmann Brothers, off 4.5%, and Merrill Lynch, Technology showed its strength as Scientific-Atlanta and EMC rose 8.7% and 7.0%, respectively.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	1.6	6.9	26	Verizon Communications	-2.3	-1.2
Petroleum	-2.7	-18.1	27	Citigroup	-2.2	-1.7
	-13.7	-52.6	28	Sun Microsystems	5.6	-34.4
	-9.5	-23.3	29	Merck	-0.4	-18.1
Materials	5.4	-11.6	30	El Paso	-8.3	-36.8
Financial	-4.6	-93.7	31	Altera	-6.4	-14.0
Petroleum	-0.6	2.7	32	Marsh & McLennan	1.0	1.6
	-1.8	-23.6	33	Household International	3.0	3.3
Gee	-0.7	-20.1	34	ChevronTexaco	-1.8	-2.6
	0.3	-33.9	35	SBC Communications	-3.5	-17.3
Brothers Holdings	-4.5	-2.7	36	Mercury Interactive	-1.0	-47.4
	7.0	-61.1	37	AOL Time Warner	-2.7	-19.3
	-5.0	-70.6	38	Washington Mutual	-1.9	-5.4
Laboratories	-1.5	5.7	39	General Dynamics	-0.1	22.4
Financial	1.0	-9.1	40	Comcast	-1.0	-11.3
Technology	3.2	-25.5	41	Morgan Stanley Dean Witter	-4.1	-14.8
	0.0	-17.0	42	Tellabs	-7.7	-65.8
Hess	0.8	-21.8	43	Exxon Mobil	-2.1	-8.8
Energy	-3.5	-12.4	44	Scientific-Atlanta	8.7	-43.4
Communications	-2.2	-56.8	45	U.S. Bancorp	1.7	-20.9
Financial	3.3	-6.7	46	Paychex	-2.5	-11.5
Petroleum	0.7	2.1	47	Merrill Lynch	-4.3	-18.5
Devices	-1.9	-1.0	48	Bed Bath & Beyond	4.5	29.0
Services	0.1	-21.2	49	Texas Instruments	-0.2	-4.2
Health	-3.4	1.3	50	Teradyne	5.2	-10.4

Production Index

Change from last week: 0.2%
Change from last year: -9.2%



index posted its first increase since before calculation of the four-week moving average, while crude-oil production and truck assemblies led the index. Freight traffic also fell, due primarily to a drop in coal traffic, while crude-oil production fell. Lumber production was up sharply, and auto production also higher.

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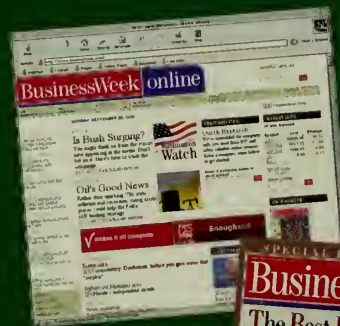
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The Ritz-Carlton, Washington, DC

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THE ROAD TO RECOVERY

The longest economic expansion in U.S. history is officially behind us, with the National Bureau of Economic Research (NBER) declaring that last March was the start of the current recession. With Congress still dithering over a stimulus package, it may be wise to take a moment to reflect on one of the most amazing business cycles this country has ever experienced. Its unique nature means that many of the features that led to phenomenal economic growth—and striking job and income gains—may not be repeated. But legacies remain and assessing today's economic damage can provide clues as to the shape of tomorrow's expansion (page 27).

Not since the 1920s has the U.S. seen a business cycle driven by investment, rather than consumer spending. In the '90s, corporations spent billions on information technology to boost productivity. Globalization opened up fresh sources of capital, goods, and labor. The Internet promised whole new ways of doing business. And the stock market became the financial engine pulling the economy along at an ever-faster speed. When the high-tech bubble burst, it revealed silly dot-com business models and ridiculous high-tech stock market valuations. Surprising to the last, the '90s business cycle ended only when a terrorist attack cracked consumer confidence. Had it not been for September 11, the NBER believes the U.S. might even have skirted the recession.

Whenever recovery comes, be it next spring or sooner, it appears likely that the Old Economy will rebound before the New. Overcapacity in high tech is a key, albeit temporary, legacy of the last decade. It may take until 2003 to work off the remaining excess in telecom, personal computers, and

chips. But manufacturers in autos, chemicals, engines, and paper restrained themselves in the '90s. As consumers cut their Christmas shopping and run down inventory, manufacturing production is poised to rev up anew and lead the recovery.

Higher productivity is perhaps the most enduring legacy of the last business cycle. Productivity growth has continued to be strong right through the downturn, suggesting that the improvement in the '90s was not a figment of the boom years but a return to the economy's historic norm of about 1% per year. Continuing at this rate should allow corporations to rebuild their bottom lines faster than during previous downturns in the '70s and '80s, when productivity was growing at only 1.4% a year. It should also permit a 3% increase in yearly gross domestic product without triggering inflation, not the red-hot growth of the boom years but solid enough for substantial increases in equity prices (page 30).

Geopolitics may provide the greatest uncertainty for the recovery ahead. National security played virtually no role in the economy of the '90s. Now it does. Security will define the level of consumer confidence and the direction of globalization could influence international capital flows. It will certainly increase the role of government in the economy.

The U.S. economy, on balance, performed remarkably well over the course of the '90s business cycle. At this point, one can tell exactly when the next cycle of recovery and expansion will start, or how strong it will be. Our guess is that given the legacies of the past, it will initially be fairly moderate. Measured against 2001, that is progress.

HOW TO CONTROL DRUG COSTS, SIMPLY

People hate pharmaceutical companies almost as much as they love their products. They demand inexpensive drugs but want drugmakers to keep spending big on research. It's a conundrum—one made worse by aging baby boomers, calls for an expensive universal Medicare drug benefit, and pleas from the Third World for cheap generics. What to do?

A new look at the debate over the soaring cost of drugs reveals a surprising number of solutions (page 60). They require a modicum of medical reform, personal self-discipline, government action, and industry competition. They don't require capping drug company profits, ending the patent system, or anything quite so drastic. Here's what should be done:

- **Get smart.** For every dollar the country spends on drugs, it wastes another dollar fixing medical problems caused by those same drugs. Doctors and hospitals are prescribing the wrong drugs to many, and too many drugs to others. Harmful side effects and drug interactions cost \$150 billion each year to cure—enough to pay for a Medicare drug benefit.
- **Get fit.** The sharp rise in drug spending is not being fueled

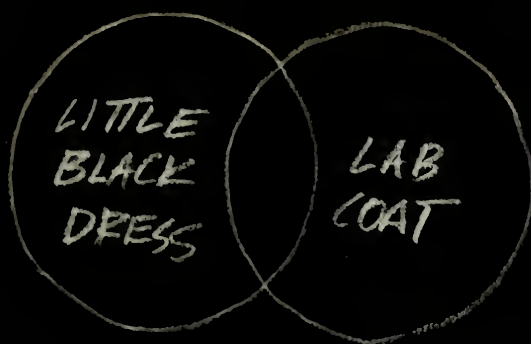
by the cancer or AIDS drugs used by a relatively small percentage of the population but by cholesterol-lowering medications, psychiatric drugs, and painkillers used by tens of millions of people. Exercise and a good diet can help reduce heart disease, diabetes, anxiety, and some pain.

■ **Get tough.** Pharmaceutical companies are gaming the patent system to stymie competition. Current law compels the FDA & Drug Administration to freeze generic versions of drugs for 30 months if a drug company complains that the generic infringes on its patent. Two and a half years is a ridiculous time; it should be shortened to three months.

■ **Get honest.** Pharmaceutical company advertising promotes high-priced new drugs with marginal improvements over cheaper generic versions. The FDA should crack down harder on misleading ads.

Despite its drug-price problem, the U.S. still spends less on medicine per person than most of Europe. There are plenty of solutions to America's complex drug-pricing problem. It's time for the country to embrace them.

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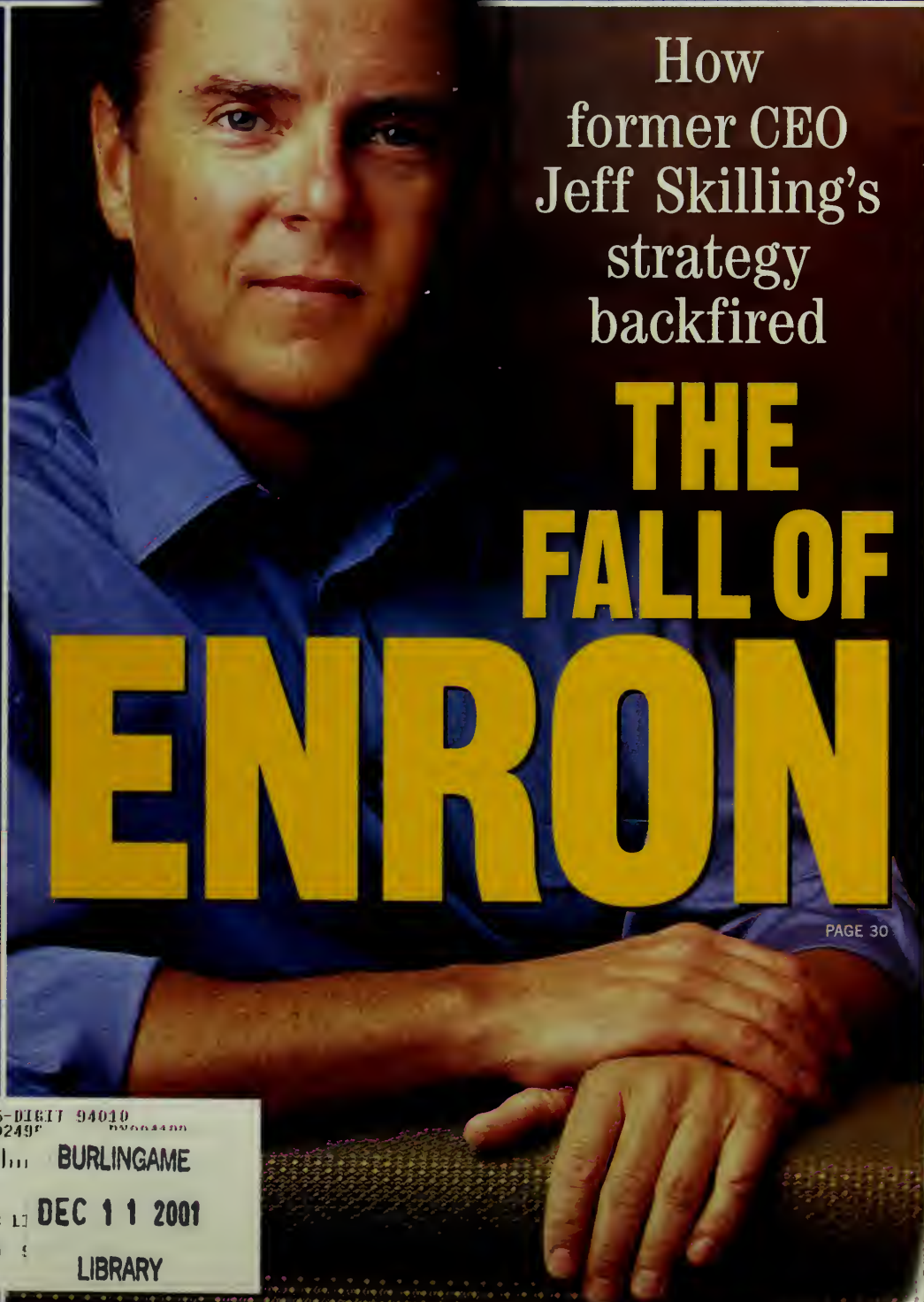
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How
former CEO
Jeff Skilling's
strategy
backfired

THE FALL OF ENRON

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NTT DoCoMo, Japan's leading mobile communications company, revolutionized mobile communications in February 1999 by introducing the first successful non-voice, data communications service, called i-mode. Since then, NTT DoCoMo has expanded i-mode's range of services and sites and attracted 29 million i-mode subscribers* in Japan.

With the October 1, 2001 introduction of fully commercialized "FOMA" 3G mobile communications, NTT DoCoMo has further strengthened the appeal of its phenomenally popular i-mode service. FOMA boosts i-mode's downlink speed to a maximum 384kbps and uplink speed to a maximum 64kbps — advantages that will surely attract heavy data communication users. FOMA technology has also enabled the introduction of a video clip service, dubbed "i-motion", on the new N2002 terminal.

With NTT DoCoMo progressing on a number of new fronts, exciting new mobile Internet service advances are sure to come. NTT DoCoMo's vision and technology will contribute to a world of mobile multimedia.

i-mode is the name used in Japan for NTT DoCoMo's mobile Internet service. FOMA (Freedom Of Mobile multimedia Access) is the name used in Japan for NTT DoCoMo's W-CDMA service. *As of November 2001

For a borderless world.

Brand New! → www.nttdocomo.com

Up Front

EDITED BY SHERIDAN PRASSO

SLUGFESTS

VICTIMS OF VALLEY LAW?

A NASTY BICOASTAL legal battle is erupting—but not in court. On Nov. 30, Harvard Law School Professor John Coates published a controversial article in the *California Law Review*. One of his key points: Companies taken public by Silicon Valley law firms in the early '90s didn't get good advice when it came to protecting against hostile takeovers, compared with those advised by New York law firms. As a result, Coates, citing one example, says these unlucky clients will have a hard time fending off unwanted suitors. The California firms "have powerful brand names and hold themselves out as 'corporate law' firms, yet they seem to have provided inferior advice," writes Coates, 37, who used to be a partner at a Manhattan firm, Wachtell, Lipton, Rosen & Katz.



COATES: Bashing California

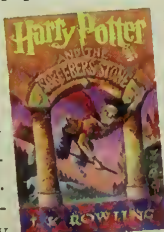
The professor's targets accuse him of misunderstanding the unique needs of technology companies—many of which do not want takeover defenses. "The article is a bunch of nonsense," says Craig Johnson, who left one of the critiqued firms, Wilson, Sonsini, Goodrich & Rosati in 1993 to start Venture Law Group. "It reflects a provincial, East Coast-centric point of view." Coates is now planning his next article, investigating, among other things, whether Valley lawyers make more mistakes. *Mike France*

EX LIBRIS

HARRY POTTER & THE TRANSLATORS' TOIL

THE MAGIC OF HARRY POTTER knows no bounds—not even language. The wildly popular boy-wizard books will soon be translated into Latin, ancient Greek, and Welsh, and out by 2003. J.K. Rowling's books are already available in 40 languages, including Zulu. "Harry Potter has become a modern-day classic," says Emma Matthewson, Rowling's editor at Bloomsbury Publishing.

Harrius Potter, as he'll be known in Latin, is in good



company. *Winnie Ille Pu* was the first children's book to appear in Latin, in 1961.

Rowling, who studied classics at Exeter University, is thrilled, says Matthewson: "The books are a treasure trove of references to classical

mythology." Bloomsbury has found a Latin translator, a retired professor who also translated *Paddington Bear*, or *Ursus Nomine Paddington*. But it's still looking for someone to handle

what Bloomsbury says will be the first children's book in ancient Greek.

If Harry can revive a dead language, he really must be a wizard after all. *Kerry Capell*

TALK SHOW "Today the Afghans have proven that, just as they were ready to die for their country, today they are ready to sacrifice and hand over power peacefully."

—Younus Qanooni, chief delegate of the Northern Alliance, at the Bonn meeting on Afghanistan

SCHOOL DAZE

SOMETHING NEW FOR MBAs: JOB TREKS

CASH-STRAPPED COMPANIES cutting back on travel and new hires have dealt a big blow to an annual ritual: MBA on-campus recruiting. Elite and not-so-elite business schools report big drops this year. At MIT's Sloan School, 47 of the 240 companies at the January, 2001, job fair have canceled this year. Others report 40% fewer recruiters, with the sharpest drops in consultants and investment banks.

So rather than wait for the jobs to come to them, students are going to the jobs. Field trips—in which students visit companies and seek out networking opportunities in the hope of getting an offer—have long been part of campus recruiting. But this year, some B-schools report doubling the number of

trips and making more of the ones they take. Cornell Johnson School usually takes 100 students on two fall trips to Wall Street and Silicon Valley. This year it added Boston and Seattle. "We're stressing that they need a plan A, a B, and plan C," says Associate Dean Dick Shafer.

More students are going on A Wharton tour of Philadelphia companies had 150 students, double last year's number.



CLASS OF 2001: Reaching out

With economic straits we're in, these trips are a critical outreach tool, says Wharton's director of MBA career management, Robert Bonner. "If you're in their door, they'll open because you're there." Most students at Duke are signing up for a "full blitz" January treks to cities such as New

York and San Francisco, says Duke's Sheryle Dirks. But the bigger issue, she notes, is companies "actually have things to do." *Ushma Patel*

THE LIST A FAMILY AFFAIR—IN ADVERTISING



DAVE THOMAS

More companies are jumping on a folksy-familial ad trend, using elderly family members to promote the authenticity of their products. Here are some examples:

- | | |
|----------------------------|---|
| S.C. JOHNSON | Samuel C. Johnson, the 73-year-old retired chairman, debuted in November talking about the strengths of family ownership. |
| COLOMBO YOGURT | Retired former owner Bob Colombosian and his Armenian-immigrant mother discuss starting the family business in Massachusetts. |
| COLUMBIA SPORTSWEAR | Chairman Gert Boyle, 77, tests jackets on her son, Tim, in extreme conditions such as being iced over in a skating rink. |
| WENDY'S | Founder Dave Thomas has been the chain's folksy spokesman for 13 years. |
| PERDUE CHICKEN | Frank Perdue started owner-turned-spokesman ads in 1971. Son Jim took over in 1995. |

Date: BusinessWeek

Software quality ↑ 80%

Developer productivity ↑ 300%

ROI ↑ 1400%

Testing time ↓ 95%

Development cycle ↓ 66%

Lump in throat ↓ 100%



Lies, damn lies and statistics, you say? Some of our customers used to be cynical, too. Before they were customers. But then they started sending us these numbers. Telling us that the results of using our best practices, integrated tools and services exceeded their expectations. Cutting test time, decreasing development cycles and reducing bugs. Freeing their teams from the obstacles that hinder software development. Need more evidence? There's plenty available at www.rational.com/customersuccess4.

be liberated

Up Front



MEDIA WATCH

MARTHA CUDDLES UP TO TECH

NOT MANY MAGAZINES ARE devoting special issues to technology these days. Then again, most don't share Martha Stewart's view of the subject. In "At Home With Technology," the December special issue of *Martha Stewart Living*, the doyenne of domestic chic takes on everything from making slipcovers for unsightly stereo speakers to ordering exotic foods off the Internet. Stewart's goal

WHIRLIGIG to liven up your PC

is to make technology accessible and aesthetically pleasing. Her tips for the tech-challenged include:

- Cord labels. Use old, plastic bread-bag clips to identify and label individual cords and wires.
- Computerized quilts. A \$4,000 digital sewing machine makes embroidering and quilting a cinch.
- Monitor whirligig. Use glassine or origami paper to make pinwheels that "spin languidly in the warm air that rises from a [computer] monitor."
- Electronic gardening journal: Software can help you decide if that purple smoke bush really belongs beside a chartreuse creeping jenny.

It makes for an eccentric package at a time when tech coverage at other publications has plummeted. Maybe victims of the dot-com purge can find comfort in computer crafts.

Diane Brady

HOW HOT ARE THEY?

The number of consoles moving on eBay may show what the game crowd really wants. As of late November, eBay was listing the following, often new, and at prices not much higher than retail:

MICROSOFT XBOX

4,124 consoles

826 games

NINTENDO GAMECUBE

2,642 consoles

524 games

SONY PLAYSTATION2

1,238 consoles

5,331 games

DRAWN & QUARTERED



PAC MENTALITY

SILICON VALLEY KEEPS ON GIVING

WITH TECH IN A SLUMP, law-makers feared the industry would reduce political giving this year. Not to worry: Silicon Valley is maintaining a surprisingly high profile despite the dot-com bust and recession.

In just the first eight months of this year, computer, software, and Internet companies and their execs funneled a hefty \$5 million to candidates and political parties, according to the nonpartisan Center for Responsive Politics. The political action committee Technology Network has raised \$300,000 for House Republicans this year, vs. \$200,000 last year.

Why are these relative

newcomers to the Washington game giving generously now? Partly the Microsoft case. Says Technet's President Rick White: "In the few years, CEOs started to understand that they can't afford to ignore the government." Execs also have more time to focus on policy than



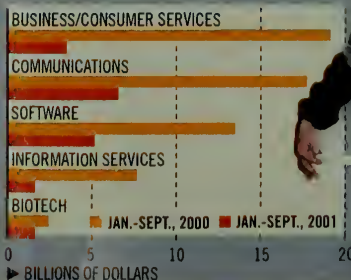
ACCESS: Bush and tech honchos

during the boom, he added. Legislation benefiting the industry also has slowed. To keep their seats at the table, techies have to keep their checks coming. Amy Borrer

THE BIG PICTURE

NOTHING VENTURED...

The amount of venture capital invested in startups has dropped about 70% since last year



VentureOne

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com



While we are always attuned to the things that find their way into our automobiles, we're equally concerned with the things that don't.

Namely pollution. So as air makes its way into the new LS 430's cabin, it's filtered for irritants such as smog, pollen and dust. And when sensors detect certain pollutants outside, the system automatically recirculates cleaner interior air for you to breathe.

All the while, the climate-control system, working like a human brain, determines where cooler air is needed and dispatches it there.

But, as the air molecules run the gauntlet, your driving experience is quite the opposite.

The Mark Levinson® Premium Sound System*

is tuned to your ear. The Lexus

DVD Navigation System*

responds to your voice.

The driver's seat heats and cools† you, as the fragrance

of leather permeates the air.

Does so much ado about things like air quality make us obsessive? Perhaps it does.

But if we dedicate so much attention to things you cannot even see, imagine what we must do with all those things that you can.

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PUTTING AN END TO THE CORPORATE NUMBERS GAME

Has anyone considered the impact on the economy of these phony numbers ("Confused about earnings?" Cover Story, Nov. 26)? When things were on the upswing, and companies were manipulating numbers in order to boost profits, I suspect that this contributed to the "bubble." Now companies are giving us phony loss numbers by throwing into their income statements all of the trash they have accumulated over the years, contributing to the collapse of the financial markets during the past year. In both cases, the use of phony numbers has exacerbated the swings in the financial markets and therefore the national economy.

James F. Reed
 Traverse City, Mich.

A study by our Center for Business Innovation found that companies that took significant "special items" (greater than 10% of net income) showed far worse operating performance over the long term than companies that avoided such charges. Companies that avoided large special items increased their earnings nearly 3% faster each year during a 10-year period than the companies

taking large special items—a finding that held for numerous industries. (The set of companies studied was the Russell 3000 index.) The study also found that companies taking large special items commanded higher price-earnings ratios than those that avoided such charges.

Over the past 10 years, there appears to have been a payoff in higher valua-

tions from taking special charges. The last observation might help explain the increasing prevalence of special charges over the past 10 years.

Eric M. Ma
 Cap Gemini Ernst & Young
 Cambridge, Mass.

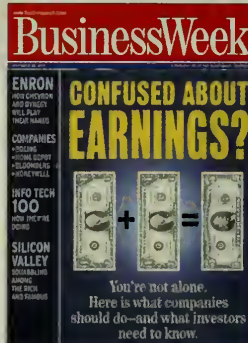
The Securities & Exchange Commission should consider adopting a system of financial examination used by the banking and insurance regulators. Audits should be taken from the public company's discretion and be subject to a lottery-type selection system run under the auspices of the Office of Chief Accountant of the SEC.

An audit "rotation" system of companies would ensure independence of the auditor and a direct line to report on questionable issues and practices. This process may well result in the elimination of "fewer options" of financial reporting by management and greater consistency in reporting by SEC firms, thereby aiding external analysis and comparability.

Jerome B. Gordon
 Managing Director
 Lutine Co.
 Fairfield, Conn.

Richard Gaumer,
 Accounting Director
 Lakeland College
 Sheboygan, Wis.

For years, CPA firms have maintained a stance as confidant to the audit clients rather than as independent auditor. With the advent of "tort reform," CPA firms no longer face steep penalties when their mistakes contribute to investor losses. CPAs have lost their professionalism that Congress intended them to have when it granted them



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Now imagine there are 40,000 people in the boat. Or 400,000. How do you keep your employees pulling in the same direction? Especially in difficult economic times, when it takes greater effort and efficiency to ensure the highest level of customer satisfaction. At Siebel, we've created Employee Relationship Management software. It gives your employees instant access to the company's knowledge and information. People can share data and tactics. Make smarter decisions. And produce better results for your customers. Now even the biggest worldwide corporation can work the way it needs to work. As one.

SIEBEL.

Good service
is good business.

Readers Report

monopoly franchise to perform truly independent audits.

Curtis C. Verschoor, CPA
Barrington, Ill.

Congratulations on your story about earnings reports that are often obfuscating—sometimes intentionally so. Your proposals left out one group that is crucial in determining the quality of reported earnings: the audit committee of the board of directors. Analysts and investors should consider the performance of the audit committee in providing credible financial information a key element in evaluating investment risk.

Nell Minow
Washington

A major part of the solution to the earnings problem is to restore dividends to their rightful place. Stocks used to have cash flow—a stream of dividends whose regularity, growth, and quality could be assessed. A strong company could keep paying dividends during downturns, and a weak company might not. Now, most equities are like a commodity whose price goes up or down according to the whims of the market, driven by reported sales and reported

earnings. Earnings will always be subject to judgment. Dividends are real, and should be the main investor cash-flow characteristic of equities.

Charles Walter Stewart
Unionville, Pa.

POLLUTING PLANTS GET BUILT BECAUSE PEOPLE NEED JOBS

"Dumping on the poor?" (Environment, Nov. 19) raises complicated issues about the conflict between environmental justice and a body of state and federal law designed to bring jobs to people who need them most. "Brown-fields" redevelopment and empowerment zones have strong support across political and racial spectra.

Having made the decision to encourage the building of plants and facilities in blighted neighborhoods, how can we then turn around and, in the name of civil rights, try to revoke duly issued permits for these jobs-producing companies to operate? And at whose expense? Environmental safety standards are typically set at state and federal levels, but zoning decisions are and always have been local political decisions. Rest assured, if the largely minority

political leadership of Camden, N.J., hadn't wanted the \$50 million Lawrence Cement Group plant in its first place, it wouldn't have been built.

Keith M. Meade
Director of Environmental Quality
National Association
of Manufacturers
Washington, D.C.

PROTECTING YOUR IDENTITY FROM THEFT

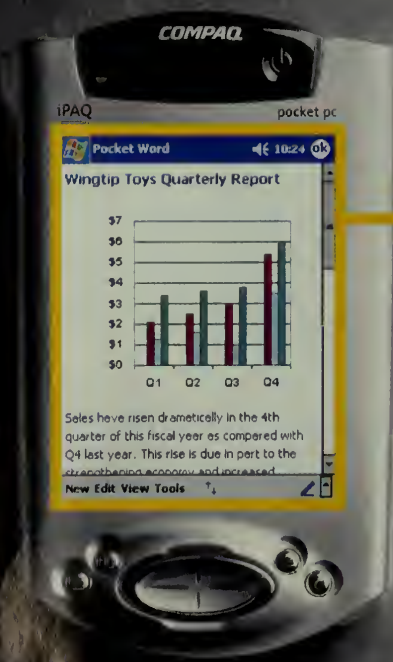
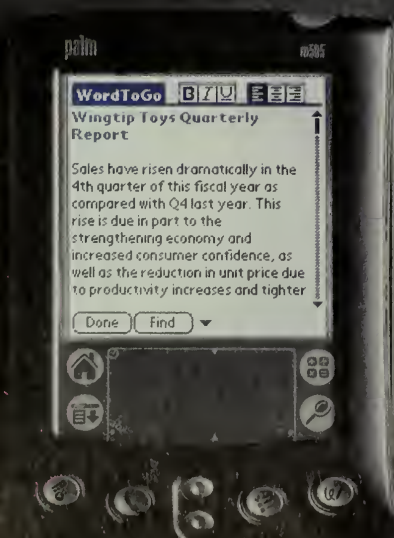
Even the most conscientious consumers can be victimized by identity thieves ("Don't let crooks steal your identity," BusinessWeek Investor, Nov. 19). Consumers who experience identity theft should report it to the Federal Trade Commission's ID Theft Hotline (toll-free 877 438-4338) or Web site (www.consumer.gov/idtheft).

The FTC's free booklet, "Identity Theft: When Bad Things Happen to Your Good Name," and the recently unveiled ID Theft Affidavit are also available from our hotline and Web site. The affidavit is accepted by the three major credit bureaus, participating creditors, and other financial institutions.

Reports of identity theft are added

Palm Powered

Windows Powered



CORRECTIONS & CLARIFICATIONS

Turning a bad year into tax savings" BusinessWeek Investor, Nov. 26) incorrectly stated that long-term capital gains lose their special tax treatment under the alternative minimum tax. They are taxed at the same rate under both the AMT and the regular tax system.

"Don't let crooks steal your identity" BusinessWeek Investor, Nov. 19), the correct price of Equifax' CreditWatch credit-monitoring service should be \$49.95 per year.

Consumer Sentinel, an online cybertool and fraud-complaint database used by hundreds of law-enforcement agencies.

J. Howard Beales
Federal Trade Commission
Washington

DECIPHERING THE FINE PRINT IN MEDICAL PRIVACY RULES

Our organization has identified 15 broad exceptions to the patient-consent requirements of the federal medical privacy regulation, including research, health-care operations, government health databases, and law enforcement. How to keep prying eyes off your

medical records," BusinessWeek Investor, Nov. 19). In addition, the National Association of Insurance Commissioners has proposed 31 exceptions to opt-in privacy requirements for medical data disclosures between banks, investment companies, and insurers. We have created privacy declaration forms for these issues. The forms are available at www.echconline.org.

Twila Brase
Citizens' Council on Health Care
St. Paul, Minn.

DID THE DONALD'S CREDITORS GET TRUMPED?

"Trump rolls the dice with his creditors" (Finance, Nov. 19) got it wrong. The first sentence states: "You'd think Donald Trump would have learned his lesson." The sentence should have read: "You'd think Donald Trump's creditors would have learned their lesson."

Laura Breyer
New York



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Pocket PC 2002

GIANTS OF ENTERPRISE

Seven Business Innovators and the Empires They Built

By Richard S. Tedlow

HarperBusiness • 512pp • \$30

REMEMBERING THE TITANS

In 1870, Britain forged more steel than the rest of the world combined. Three decades later, the U.S. was producing twice as much steel as Britain—much of it from the mills of Andrew Carnegie.

At the turn of the century, hundreds of fledgling car companies were formed, including Ford Motor Co. It wasn't clear which carmakers would survive—or that the automobile would ever be more than a plaything for the rich. Henry Ford himself had already failed twice as an auto maker. But within a few years, Ford Motor had put America on wheels, selling more than 15 million Model-Ts by 1927, when the Tin Lizzie was finally discontinued after nearly 20 years of production.

In 1945, Sears, Roebuck & Co. and Great Atlantic & Pacific Tea Co. dominated the nation's retailing landscape. That year, 27-year-old Sam Walton opened a variety store in Newport, Ark., a tiny town in a poor state in the poorest part of the country. At his death in 1992, the visionary behind the giant Wal-Mart Stores Inc. discount chain had become the most successful retailer in American history.

The achievements of Carnegie, Ford, and Walton figure prominently in Richard S. Tedlow's engrossing gallery of executive portraits, *Giants of Enterprise: Seven Business Innovators and the Empires They Built*. The other brilliant risk-takers sketched by the Harvard Business School professor are George Eastman of Eastman Kodak, Thomas J. Watson Sr. of IBM, Charles Revson of Revlon, and Robert N. Noyce of Intel. The lives of these entrepreneurs are well-known, but Tedlow performs a great service by bringing their stories together in one volume. He also deftly explores their backgrounds and the psychological impulses that drove them. After all, these are men "who broke old

rules and made new ones, who built new worlds, who were determined to govern and not to be governed, who exploited tools and techniques of which their contemporaries were only vaguely aware to serve markets which in some instances they had to create."

Such passionate and fluid writing makes *Giants of Enterprise* a pleasure to read. The book is mostly the stories of the individual men, but the professor is also eager to draw general lessons. What traits did they share that led to success, he asks? All of them, he finds, had an ability to create or adopt new technology faster and better than their peers. In general, they embraced change. For instance, prior to the 1880s, professional photographers and serious amateurs rejected technological advances toward a less complicated art. Eastman seized on the new techniques and developed a mass market for them, as embodied in the easy-to-use Kodak Brownie. Moreover, he found that the best way to maintain an edge over rivals was not through the monopolistic trade restraints favored by innovators of previous decades, but with an organization capable of "a rapid succession of changes and improvements." To build such a "learning organization," he forged close relations with universities, invested in basic research at Kodak Park, and hired college graduates.

Tedlow also plumbs each executive's personality, finding that entrepreneurial genius has a dark side. Tedlow's innovators succeeded through brainpower—by thinking large. Yet eventually, he says, most of these tycoons suffered a mental "derangement," losing their grip on reality as a result of their tremendous influence. They were surrounded

by people who made sure they never had to deal with any of the minor annoyances that trouble even upper middle-class households. Typically, the friends were equally protected members of the ultra-rich. In this account only George Eastman, clearly Tedlow's favorite giant of enterprise, escapes this kind of mental imbalance.

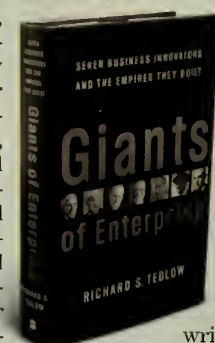
Take Carnegie. The power the steel maker had exercised since the 1860s persuaded him that he alone could solve the problem of human aggression. So at his retirement, Carnegie embarked upon a two-decade crusade for world peace. Among his many embarrassing missteps was an enthusiastic embrace of Germany's Kaiser Wilhelm II, who was the midist of a huge military buildup prior to the Great War. "In this quarter [Carnegie] was as complete a failure as he was a success at making money in the steel industry," writes Tedlow. "It was worse than a failure; he was a fool."

At least Carnegie's intentions were noble. The same can't be said for Henry Ford, the one whose Tedlow likes least—a man with good reason. Yes, Ford was the "Copernicus of cars." But he was also a sadistic, vindictive man who drove his son to an early grave, and a vicious anti-Semite to boot. "Ford provides as stark an illustration of the derangement of power as one is likely to find," writes Tedlow.

Tedlow also ponders why Americans have proved so good at creating companies. Like others before him, he finds the key to be the nation's openness to talent. He acknowledges historic bias against women and racial minorities—but finds that today there are more opportunities than ever for brains, energy and character, regardless of a person's background.

Put it this way: In America, a defining ideal is that everyone should get a chance to be unequal, to accumulate riches. It's likely that in another half-century a comparable history will profile an equally successful but far more diverse group of capitalists who will have transformed the way we live and work.

BY CHRISTOPHER FARRELL
Farrell is a contributor to
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FINALLY, A HYBRID THAT REALLY WORKS



Handspring's Treo shows that the phone and the handheld can hit if off as a couple

Few combinations have seemed quite as natural to me as cramming a wireless phone and a handheld computer into a single package. A lot of people carry both, and obvious links between the contact list and calendar of the handheld and the phone mean that they are often, and awkwardly, in use together. But previous attempts at combos have had limited success.

The Treo 180 from Handspring is a breakthrough. It makes a perfectly good, if slightly bulky, phone while offering the full function of a Palm, whose software the Treo uses under license.

It is also the first radical redesign of the Palm in its six-year history, offering a tiny, but usable, keyboard for data entry. The 180 will be available early in 2002 for around \$399 with a wireless service agreement.

Another version, the 180g, uses the Palm's more traditional Graffiti character recognition to enter data. A color version costing \$200 more is scheduled to arrive midyear.

The Treo cannot use the various Springboard modules, such as cameras or music players, which can be attached to other Handsprings. That's just as well, because these modules would only be in the way when using the Treo as a phone.

CLEVER DETAILS. Unlike most hybrid efforts, the Treo leaves no doubt about where its first allegiance lies: It's a phone that doubles as a Palm. One clear indication of this is the reworking of the familiar four Palm buttons. Only the date-book button is unchanged. The contacts button has mutated into a button that activates the phone. The to-do list and memo buttons are gone, and their replacements activate a Web browser and e-mail. You launch other applications by pressing a menu key, then tapping a screen icon. A wheel to the left helps you quickly scroll through your phone directory or other lists.

The Treo is a marvel of thoughtful design. At 2.7 inches wide and 4.3 inches long, slightly

smaller than standard Palm handhelds, the Treo looks like a big flip-phone. When you open the lid, the Treo turns on with your speed dials played. Tap the phone button and an on-screen dial-pad appears. Another tap brings up your phone list. Unlike hybrids such as the Kyocera Smartphone or the Samsung I300, the Treo is comfortably used without an earplug as a phone. Not only is it small and light but the flip-phone sign means you're unlikely to get skin oil or makeup all over the screen. Little details like that make a vast difference in usability.

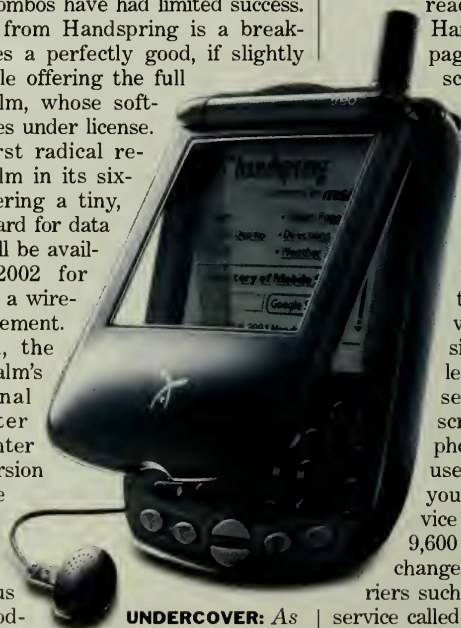
The Treo is significantly bulkier than most phones. On top of the ability to double as a Palm, the payoff is that the Treo can handle wireless data. The 160-by-160-pixel display is vastly better than any phone for getting information from the Web or handling e-mail.

Like the mini-browsers in phones, which can only read specially formatted Web pages, Handspring's Blazer browser reformats pages for display on the Treo's screen, though not all sites are handled with equal success. The built-in One-Touch Mail program from JP Mobile lets you e-mail from a standard Internet account.

ALL THUMBS. The catch, for the moment, is Internet access. The Treo runs on the GSM network, which is the standard for most of the world and will soon become pervasive in the U.S. with the conversion of the AT&T and Cingular Wireless systems. The Treo lets you easily send a text message to any GSM subscriber in the world just by using phone number as an address. But to use conventional e-mail or the Web, you must first dial up an Internet service provider, then put up with speed of 9,600 bits per second, at best. This will change dramatically next year, when carriers such as VoiceStream Wireless roll out service called GPRS, for which Handspring plans software upgrade. Your Treo then should connect to the Internet whenever the phone is turned on and speeds would increase at least fourfold.

As a confirmed Graffiti user, I have mixed feelings about the keyboard. Handspring clearly modeled the keyboard, best used with two thumbs, on Research In Motion's BlackBerry. On the whole, it is a successful imitation, down to the automatic conversion of entries such as "in" to "I'm" and "don't" to "don't," but the absence of a right shift key is annoying. I also found that efficient operation often required the use of both the keyboard and a stylus to tap the screen. Still, many folks who have avoided learning Graffiti will welcome the keyboard.

The Treo is the most successful design to date of a handheld with an integrated phone. Perhaps as important is the first major change in the basic design of a Palm. Let's hope it marks the first of a run of creative products from Palm and its partners.



UNDERCOVER: As soon as you flip the Treo's lid, the display turns on

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BY JEFFREY E. GARTEN

THE WRONG TIME FOR COMPANIES TO BEAT A GLOBAL RETREAT



OUTLOOK:
The terrorist attacks and the recession have CEOs reassessing overseas strategies. Corporate America will be hurt if they get too cautious

Jeffrey E. Garten is dean of the Yale School of Management. A former investment banker, Garten is the author of *The Mind of the C.E.O.* (jeffrey.garten@yale.edu).

A slowdown of American corporate expansion abroad may be one result of the terrorist attacks. To be sure, cutbacks in foreign direct investment already had begun in previous months as the global recession took hold. But following September 11, it may have accelerated into a retreat from globalization itself.

Since the summer, for example, Gateway Computer Inc. announced it was shedding most of its foreign operations in Europe and Asia. AT&T dissolved its joint venture with British Telecommunications. Merrill Lynch & Co. began pulling back from Asia. Ford Motor Co. said it would be shrinking its operations in Europe. There has also been a major slowdown in the expansion of U.S. telecom and energy companies in South America.

INCREASED RISK. Admittedly, U.S. companies have their reasons for caution. Many are, after all, reeling from the collapse of the Internet bubble, an economic downturn at home and abroad, and intense pressure on quarterly earnings. But perhaps more important, September 11 changed the mindset of many global CEOs. Globalization used to mean openness, but now there is anticipation of more government involvement. Globalization used to mean new opportunity, but now there's a sense of growing vulnerability. Some CEOs see increased security risks abroad to their supply chains, their factories, and their employees. Some fear that their companies could be targets of anti-American fanatics.

Ralph Shrader, CEO of consulting firm Booze Allen & Hamilton, recently told me he doesn't know of any companies that aren't carefully reassessing their global strategies in light of the recession and September 11. Sir Martin Sorrell, CEO of WPP Group, the advertising, marketing, and research firm, recently described many American CEOs as "deer caught in the headlights," their global strategies paralyzed. The trend is apparently global and extends beyond U.S. corporations: Cross-border mergers are down 50% since this time last year, and flows of direct foreign investment around the world are projected to drop this year by 40% from 2000.

There are also two noticeable exceptions to the slowdown in globalization. One is the NAFTA region, where Citigroup's recent acquisition of Banamex, one of Mexico's largest banks, could be a precedent for many more linkups, as could Calpine Corp.'s move into Canada. And China, now a member of the World Trade Organization, has become too compelling a destination for investors to miss. Investment that would

have gone into many Asian countries is now flowing into just one—China. Look at AOL Time Warner's just-concluded joint venture with China's largest computer company, the Legend Group, and Wal-Mart Stores' announcement that it would build five new stores in Beijing alone.

But the brighter picture for NAFTA and China does not erase the dangers of a globally hesitant Corporate America. A quarter of U.S. trade is conducted between American companies in the U.S. and their overseas subsidiaries. As foreign investment abroad slows, therefore, so will American exports, which accounted for 20% to 30% of gross domestic product growth in the 1990s and supported millions of high-paying jobs. And we will imports that have helped to hold down prices and provide more choices to consumers. In addition, given the importance of U.S. foreign investment as a provider of money, management and technology, the economic prospects of several regions of the world will be undercut by a slowdown of American investment, adding additional drag to the global market. Because we are so interdependent, the slowdown will hurt us too.

NEW COMPETITORS? U.S. corporations themselves will forfeit their ability to build a wide customer base. They could be opening the door to new long-term competitors, too. During the 1980s' debt crisis in Latin America, for example, companies like Bank of America and AT&T pulled in their horns. It took 10 to 15 years for U.S. companies in the developing world to recover lost ground from their European counterparts. Because of problems in the U.S. market, Ford and General Motors Corp. pulled back overseas in the 1970s and '80s; Japan filled the vacuum and continues to do so. Companies in emerging market nations themselves could now become rivals, too. "The biggest competitive threat on the horizon," former General Electric Chairman Jack Welch told me recently, "are those companies whose names we can't spell or pronounce."

It would be seriously counterproductive if Corporate America were turning inward just now. Washington is building the base for widespread multilateral cooperation, including a push for new global trade liberalization. We all know that the war against terrorism must be waged not only by our military troops but also by an economic development effort that gives poorer nations the chance to become something other than breeding grounds for frustration and violence. That can't happen with foreign aid alone. If U.S. corporate investment doesn't play a major role, peace may never happen.



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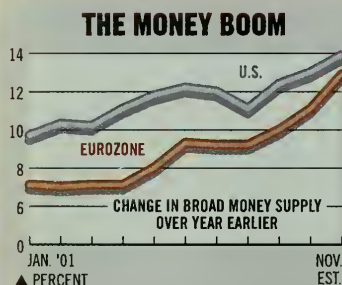
PORSCHE

EDITED BY MICHAEL J. MANDEL

MONEY, MONEY EVERYWHERE

High liquidity won't spur inflation

Even as the global economy slows to a halt, liquidity is surging worldwide. In the U.S., repeated interest rate cuts by the Federal Reserve mean that M3 (the broadest indicator of money supply, including bank deposits and money-market mutual funds) rose by almost 14%, year-on-year, to the end of



Data: European Central Bank, Federal Reserve Bank, Credit Suisse First Boston

October. That's the fastest rate of growth in more than 20 years. In the euro zone, M3 grew by almost 8%, quicker than at any time since 1993. There has even been an M3 uptick recently in Japan, where money supply had been shrinking for four years. "There's plenty of money just about everywhere," says Mary Davis, an economist at Credit Suisse First Boston in London. "We've never seen liquidity increasing so fast right around the world."

Nevertheless, most economists now believe that the liquidity overhang is not likely to have much impact on inflation. Classical theory teaches that a rapid increase in the supply of money should quickly feed through to higher prices. But that isn't happening this time. Japan is worried about deflation, not inflation. In the U.S., inflation is heading down as unemployment rises. And forecasters now predict that inflation will plunge in the euro zone, from 2.4% in October to 1% by the end of 2002. "We don't see any reason to worry about inflation for at least a year," says Carlo Monticelli, co-head of European economics at Deutsche Bank. "Even then, we don't think it will be a problem in the medium term."

One reason is that industrial production and business and consumer confi-

dence continue to tumble in most countries. Unemployment is climbing. And competition from low-wage developing countries will help keep prices under control.

To be sure, economists say there is a clear link between surging M3 and the recovery of equity prices in October and November. Moreover, the massive increase in liquidity has helped the financial markets withstand the Enron Corp. bankruptcy and the turmoil in the Middle East. But they say this doesn't mark the start of an asset price boom or an upswing in retail prices.

By David Fairlamb

LOST JOB, LOST SPOUSE

Being fired can lead to divorce

Everyone knows that financial stress can help break up a marriage. But a new study from the National Bureau of Economic Research Inc. shows that some financial problems are more likely than others to lead to divorce.

In particular, the authors of the study, Kerwin Kofi Charles of University of Michigan and Melvin Stephens Jr. of Carnegie Mellon University, find that being fired from a job significantly raises the probability of getting divorced. Married men who are fired have an 18% higher chance of being divorced within the next three years, while women have a 13% higher chance.

But someone losing his or her job because of disability doesn't mean a significantly increased probability of seeing the marriage break up. Similarly, a plant closing that affects a group of people doesn't raise the odds of divorce.

By way of explanation, Charles and Stephens suggest that the character traits that cause a person to be laid off could also make him or her a bad mate. "For example, if a wife can conclude that a husband lost his job because of his repeated irresponsibility or bad temper," they write, "she should conclude both that he is likely to face employment troubles in the future and that he may not be a good person with whom to raise children."

By contrast, a plant closing or a sudden disability is viewed as bad luck rather than a deserved punishment for a bad personality. These events are less likely to spark a divorce even though, in the case of disability, the income loss to the couple is generally greater.

By Margaret Popper

THEY STILL BUY AMERICAN

U.S. debt remains popular abroad

The events of September 11 shook foreign investors' faith in the U.S. as a safe haven for their money. Even before the attacks, money flows into the country had been slowing (chart). And after the direct hit on the nation's financial capital, some economists feared that foreign investors would go rushing for the door. Indeed, initial data show that in September, foreign portfolios shed \$1 billion worth of U.S. stocks and about \$1 billion worth of U.S. Treasury securities.

But foreign investment in the U.S. has been more resilient than was expected. While foreign investors dumped stocks in September, they increased the total U.S. investment portfolios by \$1 billion by purchasing corporate bonds and debt issued by government-sponsored lenders such as Fannie Mae and Freddie Mac.

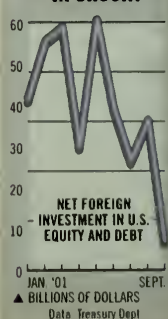
Numbers to be released later this month will likely show that capital flows rebounded in October, says Joseph P. Quinlan, a senior global economist at Morgan Stanley Dean Witter & Co. "The market is expecting a quick resolution to Afghanistan and is looking at the U.S. economy to be the first to emerge from global recession," he says.

History suggests that in times of conflict, capital inflows recover quickly or it is clear the U.S. is winning the war. For example, says Quinlan, in the two months after Iraq's invasion of Kuwait in August, 1990, foreign investment in U.S. debt and equities fell by \$6.6 billion. But foreign investors responded to the successful American counterattack in January, 1991, by buying up large amounts of U.S. government debt.

So, unless the war against terror takes a sudden turn for the worse, there may be a quick recovery in foreign investment. Indeed, with Japan in the midst of an economic crisis and the European Central Bank's interest-rate cuts lagging the Fed's, U.S. equities are likely to be the best game in town for many months.

By Margaret Popper

FOREIGN INVESTORS IN SHOCK?



Data: Treasury Dept

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JAMES C. COOPER & KATHLEEN MADIGAN

CORPORATE AMERICA'S CLEARING A PATH TO RECOVERY

Inventories are dwindling and balance sheets are being shored up

U.S. ECONOMY

For about a year prior to September 11, U.S. businesses were adjusting to a new reality of slower demand at home and abroad, after the unsustainable boom in 1999 and early 2000. The September shock only made matters worse. However, there are now indications that companies' two biggest problems—excessive inventories and the hangover from too much capital spending—are beginning to work themselves out.

"Beginning" is the key word here, but a few encouraging signs for the outlook have cropped up. Orders for durable goods rebounded in October, and the November purchasing managers' index of industrial activity rose, lifted by a big bounce in new orders (chart). The nonmanufacturing PMI also jumped last month. In addition, revised data by the Federal Reserve show that producers of high-tech equipment may be dealing with less excess capacity than initially thought.

INDUSTRY SHOWS SOME POST-ATTACK RESILIENCE



Surprisingly resilient in the fourth quarter, will not bounce back next year to the 5%-plus pace seen during the economy's boom period. And foreign demand won't be providing any help because the rest of the world is either in or close to recession.

Even so, these nascent signs of improvement on the inventory and capital-spending front are important to the outlook for the industrial sector, the economy's first area to crumble more than a year ago. And they are crucial to the overall economy's future because a healthier industrial sector is a key component of a true U.S. recovery.

PERHAPS THE MOST HEARTENING NEWS for the industrial sector is the speed with which excess inventories are being brought into line. Based on the revised data for third-quarter gross domestic product, businesses liquidated inventories last quarter at the

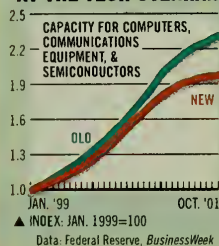
fastest rate in any quarter since World War II.

This faster liquidation played a big role in the downward revision in overall GDP growth from a dip of just 0.4% to a 1.1% decline. The inventory runoff, which began in the first quarter, is now the largest in any three-quarter period. So far this year, final demand for goods has declined at an annual rate of 0.2%, while business inventories have fallen at a 2.8% clip. Eventually this disparity will fuel gains in goods production.

Another hopeful sign is that the steepest cutbacks in capital spending, a major source of the inventory adjustment, may be over. The financial fundamentals that will support a pickup in spending are coming together. First, the rally in the bond market, along with past Fed rate cuts, have lowered borrowing costs.

Second, despite weak third-quarter profits, corporate cash flow is now rising. Profits in the third quarter, based on the Commerce Dept.'s economywide roundup, fell 8.3% from the second quarter and 22.2% from a year ago. Even excluding financial companies and the hit to insurers from the September 11 disasters, earnings at nonfinancial companies plunged 26.5%. But cash flow, which adds back depreciation, managed to rise by \$12 billion, the first increase in a year. This is a sign that improving financial conditions are helping corporations to repair their balance sheets.

A REVISED LOOK AT THE TECH OVERHANG



EVEN THE TECH SECTOR, which is hardwired into the capital-spending outlook, is showing a few signs of working through its problems. Although overall industrial production dropped a steep 1.1% in October, output losses in the tech sector are getting smaller. In the past three months, production losses in the tech industry—including computers, office equipment, communications equipment, and semiconductors—have averaged 0.9% per month, compared with declines averaging 2.8% per month in the spring and summer.

Moreover, new Fed data suggest that the excess capacity in the tech sector is a bit less than the original data had implied (chart). The Fed's annual revision of industrial production and capacity shows that tech output capacity did not grow as rapidly last year as first thought, and that the slowdown in capacity growth

this year has been much steeper. The new data show that growth in tech capacity fell from a peak of 43% last year to 15% in October, much greater than the slowdown from nearly 50% to 24% in the old data.

Clearly, there is still a problem. Tech output is shrinking 17% per year through October, and data for overall capital goods shipments imply another sharp drop in equipment outlays in this quarter. However, tech orders, which had been falling like a stone for a year, rebounded in October to the highest level since June. And the ratio of tech inventories to sales, while still high, fell in October for the second month in a row.

THE BIGGEST REASON FOR OPTIMISM that excesses in production capacity and inventories will be brought under better control in coming months is the surprising resilience of consumers in the face of the September 11 shocks. That's one source of demand that remains stalwart.

Led by a surge in car sales, real consumer spending in October soared 2.2% from September, when it plunged 1.1% (chart). It was the largest monthly increase in 15 years, fueled by a 27.9% jump in sales of cars and parts, the biggest gain on record.

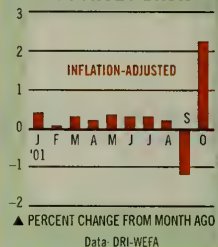
October buying assures that consumer spending will make a significant positive contribution to fourth-quarter economic growth. For example, even if outlays fall back by 1.5% in November and don't grow at all in De-

cember—assumptions that are highly conservative real consumer spending will rise at an annual rate 2% for this quarter. That gain may be large enough to keep overall GDP from declining.

November car buying did decline from October's record annual rate of 21.3 million, but only to a still-strong 18 million pace, as many companies left their generous incentive programs in place. Car sales have been higher during this recession than they were prior to the downturn. Plus, November retail sales outside of car buying look healthy, based on weekly reports. The holiday buying season may not be as bad as many analysts had feared, although the heavy discounting needed to lift sales will likely hurt merchant retailers' profits.

Undoubtedly, increasingly weak labor markets will limit consumers' contribution to growth next year. But even a modest pace of consumer spending will help to offset the ongoing drags from business and foreign demand. Given the progress that businesses have already made and the improving fundamentals for growth, the industrial sector—and the overall economy—may not be too far from righting itself.

CONSUMER SPENDING BOUNCES BACK



JAPAN

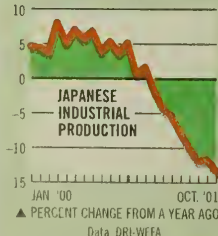
THE WORLD'S NO. 2 ECONOMY TEETERS ON THE BRINK

Japan's economic situation is ever closer to spiraling out of control. Recent grim data show that the economy is in free fall. Prices and wages are declining, creating a self-reinforcing contraction in employment and output, as dysfunctional policy-makers squabble over what to do about it all.

Japan is almost certainly in its worst recession in at least 20 years. Real gross domestic product began falling in the second quarter, and lacking any engine of growth, economists expect it to shrink through mid-2002. October data were dismal. Industrial production dropped to a 13-year low, as exports fell and businesses cut their capital spending. Retail

sales sank for the seventh month in a row, and housing starts declined, despite the Bank of Japan's zero-interest-rate policy. Unemployment rose to a record 5.4%, and confidence is plummeting.

THE SLIDE IN OUTPUT IS PICKING UP SPEED



government debt equal to 130% of GDP, and a budget deficit greater than 6% of GDP. Any fiscal-policy efforts to stimulate the economy will add to the debt problem and run counter to reform efforts.

The big worry, however, is deflation, which threatens to destabilize the financial system. Consumer prices in October fell 0.8% from a year ago, and they have been falling for two years. Any speedup in that rate of decline will make debt burdens, both public and private, increasingly onerous, since deflation lifts the real cost of paying back a loan. Banks are already saddled with more than \$1 trillion in bad loans, by some estimates, and many large banks may have exposures to the recently bankrupt Enron Corp.

The hope is that the government will take over the bad loans with funding from the BOJ. Banks have increased their loan-loss reserves recently with the apparent help of the BOJ, but progress is too slow to remove the growing threat of a serious financial crisis.



The smiles around the conference room table have yet to fade when reality starts to sink in:

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How ex-CEO Jeff Skilling's strategy grew so complex that even his boss couldn't get a handle on it

To former Enron CEO Jeffrey K. Skilling, there were two kinds of people in the world: those who got it and those who didn't. "It" was Enron's complex strategy for minting rich profits and returns from a trading and risk-management business built essentially on assets owned by others. Vertically integrated behemoths like ExxonMobil Corp., whose balance sheet was rich with oil reserves, gas stations, and other assets, were dinosaurs to a contemptuous Skilling. "In the old days, people worked for the assets," Skilling mused in an interview last January. "We've turned it around—what we've said is the assets work for the people."

But who looks like Tyrannosaurus Rex now? As Enron Corp. struggles to salvage something from the nation's largest bankruptcy case, filed on Dec. 2, it's clear that the real Enron was a far cry from the nimble "asset light" market maker that Skilling proclaimed. And the financial maneuvering and off-balance-sheet partnerships that he and ex-Chief Financial Officer Andrew S. Fastow perfected to remove everything from telecom fiber to water companies from Enron's debt-heavy balance sheet helped spark the company's implosion. "Jeff's theory was assets were bad, intellectual capital was good," says one former senior executive. Employees readily embraced the rhetoric, the executive says, but they "didn't understand how it was funded."

Neither did many others. Bankers, stock analysts, auditors, and Enron's own board failed to comprehend the risks in this heavily leveraged trading gi-

ant. Enron's bankruptcy filings show \$13.1 billion in debt to the parent company and an additional \$18.1 billion for affiliates. But that doesn't include at least \$20 billion more estimated to exist off the balance sheet. Kenneth L. Lay, 59, who had nurtured Skilling, 48, as his successor, sparked the first wave of panic when he revealed in an Oct. 16 conference call with analysts that deals involving partnerships run by his company would knock \$1.2 billion off shareholder equity. Lay, who had been out of day-to-day management for years, was never able to clearly explain how the partnerships worked or why anyone shouldn't assume the worst—that they were set up to hide Enron's problems, inflate earnings, and personally benefit the executives who managed some of them.

That uncertainty ultimately scuttled Enron's best hope for a rescue: its deal to be acquired by its smaller but healthier rival, Dynegy Inc. Now Enron is frantically seeking a rock-solid banking partner to help maintain some shred of its once-mighty trading empire. Already, 4,000 Enron workers in Houston have lost their jobs. And hundreds of creditors from banks to telecoms to construction companies, are trying to recover part of the billions they're owed.

From the beginning, Lay had a vision for Enron that went far beyond that of a traditional energy company. When Lay formed Enron from the merger of two pipeline companies in 1985, he understood that deregulation of the business would offer vast new opportunities. To exploit them, he

turned to Skilling, then a McKinsey & Co. consultant. Skilling was the chief nuts-and-bolts-operator from 1997 until his departure last summer, and the architect of an increasingly byzantine financial structure. After he abruptly quit in August, citing personal reasons and his right-hand financier Fastow was ousted Oct. 24, there was no one left to explain it.

Much of the blame for Enron's collapse has focused on the partnerships, but the seeds of its destruction were planted well before the October surprises. According to former insiders and other sources close to Enron, it was already on shaky financial ground from a slew of bad investments, including overseas projects ranging from a water

THE FALL OF

ENRON



DEC. 31
1996
21.50

AUG. 17
2000
\$90

ENRON'S STOCK PRICE

ata: Bloomberg
Financial
Markets

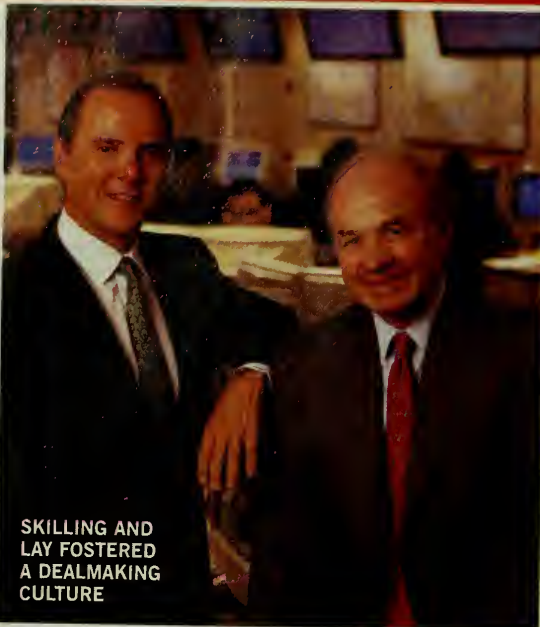
NG PRETTY:
LING AT NEW
QUARTERS IN
2000

DEC. 5
2001
\$1.01

business in England to a power distributor in Brazil. "You make enough billion-dollar mistakes, and they add up," says one source close to Enron's top executives. In June, Standard & Poor's analysts put the company on notice that its underperforming international assets were of growing concern. But S&P, which like *BusinessWeek* is a unit of The McGraw-Hill companies, ultimately reaffirmed the credit ratings, based on Enron's apparent willingness to sell assets and take other steps.

Behind all the analyses of Enron was the assumption that the core energy business was thriving. It was still growing rapidly, but margins were inevitably coming down as the market matured. "Once that growth slowed, any weakness would start becoming more apparent," says Standard & Poor's Corp. director Todd A. Shipman. "They were not the best at watching their cost." Indeed, the tight risk controls that seemed to work well in the trading business apparently didn't apply to other parts of the company.

Skilling's answer to growing competition in energy trading was to push Enron's innovative techniques into new arenas, everything from broadband to metals, steel, and even advertising time and space. Skilling knew he had to find a



SKILLING AND LAY FOSTERED A DEALMAKING CULTURE

SKILLING'S STRATEGY THE BIG IDEA

► Create an "asset light" company. Skilling applied Enron's trading risk-management skills to power plants and other facilities owned by outsiders. To maintain a high credit rating and raise capital, Enron moved many of its own assets off the balance sheet into complex partnerships.

► Expand Enron's energy trading expertise into a vast array of new commodities to sustain earnings growth. Skilling envisioned taking markets ranging from paper goods to metals to broadband capacity.

way to finance his big growth plans and manage the international problems without killing the company's critical investment-grade credit rating. Without a clever solution, trading partners would flee, or the cost of doing deals would become insurmountable.

"HE'S HEARTBROKEN." No one ever disputed that Skilling was clever. The Pittsburgh-born son of a sales manager for an Illinois valve company, he took over as production director at a startup Aurora (Ill.) TV station at age 13 when an older staffer quit and he was the only one who knew how to operate the equipment. Skilling landed a full-tuition scholarship to Southern Methodist University in Dallas to study engineering.

A STAR IS BORN, THEN BURNS OUT

JANUARY, 1997 Jeffrey Skilling is named president and COO. In six years, he had put Enron on the map as a natural-gas and electricity trading powerhouse.

JULY Enron pays \$3.2 billion for Portland General Electric to combine the utility's wholesale and retail electricity expertise with Enron's natural-gas and electricity marketing and risk-management skills.

AUGUST Enron branches out beyond energy, introducing commodity trading of weather derivatives.

MAY, 1998 Rebecca Mark, a rising star who helped cinch Enron's \$3 billion power plant in Dabhol, India, in the early '90s, is named vice-chair. She had been a rival

to Skilling as a successor to Chairman and CEO Ken Lay.

JULY Enron pushes into foreign markets, paying \$1.3 billion for the main power distributor to São Paulo and \$2.4 billion for Britain's Wessex Water. Wessex becomes a building block for Mark's new global water business, Azurix Corp.

APRIL, 1999 Enron agrees to pay \$100 million to name Houston's new baseball stadium Enron Field.

JUNE Enron sells a third of Azurix to the public, raising \$695 million.



REBECCA MARK



DABHOL: MARK MADE A NAME FOR HERSELF WITH THE POWER PLANT

NOVEMBER Skilling launches EnronOnline, a Net-based commodity trading platform. A few days later, proclaiming

"this is Day One of a potentially enormous market," introduces trading of broadband capacity.

IT WENT WRONG?

THE PROBLEM

Partnerships required Enron in stock if its rating and stock fell below a certain point. It could be left holding the bag out \$4 billion in debt. With its stock and asset values falling, Enron was vulnerable. And when things started to unravel, its murky finances scared investors and lenders.

Enron tried to do too much, too fast, with little or no return. It invested \$2 billion in fiber-optic capacity and trading facilities, but the broad-market crash crashed. And it was unable to show that it could generate the profits it got from energy trading in markets such as metals.



ENRON'S INTELLECTUAL CAPITAL: TRADERS

Enron, but quickly changed to business. After graduation, he went to work for a Houston bank. The bank later went bust while Skilling was at Harvard Business School. Skilling said that fiasco made him determined to keep strict risk controls on Enron's trading business. He once told *BusinessWeek* that "I've never not been successful in business or work, ever." Skilling now declines to comment, but his brother, Tom, a Chicago TV weatherman, says of him: "He's heartbroken over what's going on there.... We were not raised to look on these kinds of things absent emotion."

Enron's "intellectual capital" was Skilling's pride and joy. He recruited more than 250 newly minted MBAs each year

from the nation's top business schools. Meteorologists and PhDs in math and economics helped analyze and model the vast amounts of data that Enron used in its trading operations. A forced ranking system weeded out the poor performers. "It was as competitive internally as it was externally," says one former executive.

It was no surprise then that Skilling would turn to a bright young finance wizard, Fastow, to help him find capital for his rapidly expanding empire. Boasting an MBA from Northwestern University, Fastow was recruited to Enron in 1990 from Continental Bank, where he worked on

2000 Enron launches metals trading.

ST A power shortage in California, and state officials blame Enron and its energy outfits. Problems in the oil market drive its stock to down from \$19 at the time. Mark resigns as Azurix' and an Enron director.

EMBER Enron launches trading of wood products.

MBER Skilling is promoted to CEO, effective Feb. Enron's stock has dropped 87% in 2000. Enron is to take Azurix private.

CH, 2001 California officials investigate alleged gouging by Enron and power marketers.

Enron execs sold

shares in the first half as the stock slid 39%. Skilling's total: \$17.5 million.

AUGUST Skilling stuns investors by quitting, for "personal reasons." Lay reclaims the CEO title.



ANDREW FASTOW

OCT. 16 Enron reports a third-quarter loss of \$618 million and shrinks shareholder equity by \$1.2 billion, citing losses due partly to partnerships run by then-CFO Andrew Fastow.

OCT. 22 Enron says the SEC has started an inquiry into Fastow's partnerships. Two

days later, he's out.

OCT. 31 Enron sets up a committee to conduct an investigation of its accounting.

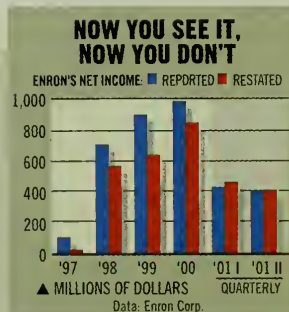
NOV. 8 Net income is revised back through 1997, trimming it by \$586 million.

NOV. 9 Dynegy Corp. agrees to buy Enron for \$10 billion.

NOV. 15 Lay says Enron made billions of dollars of "very bad investments."

NOV. 19 Enron says it may have to repay a \$690 million note and take a \$700 million pretax charge.

NOV. 28 Dynegy bails out of the



merger after seeing unanticipated debt and cash flow problems in Enron's 10Q filing. Enron's credit is downgraded to junk status.

DEC. 2 Enron files for the largest Chapter 11 reorganization in history.

Data: Company reports, *BusinessWeek*



CHUCK WATSON

EVERYONE LOVED ENRON

Here's what some management gurus said about Enron's rise, and what they think now

JAMES J. O'TOOLE

Professor, Univ. of Southern Calif.



BEFORE

“Leadership is not a solo act... it is a shared responsibility, a chorus of diverse and complimentary voices. To an unusual degree, [Enron] is chock-full o' leaders...”

AFTER

“Egg all over the face is an understatement. As embarrassing as it is, we basically took the word of Lay and his people. Was there a way to spot that the emperor was wearing no clothes? I don't think so.”

CHRISTOPHER A. BARTLETT

Professor, Harvard Business School



BEFORE

“Skilling and Lay created ‘a hotbed of entrepreneurial activity and an engine of growth.’”

AFTER

“There are absolutely some strong, helpful lessons to learn by what they did right. Unfortunately, all those are trumped by the mistakes they made.”

GARY HAMEL

Chairman of consultant Strategos



BEFORE

“Enron isn't in the business of eking the last penny out of a dying business but of continuously creating radical new business concepts with huge upside.”

AFTER

“Do I feel like an idiot? No... If I misread the company in some way, I was one of a hell of a lot of people who did that.”

SAMUEL E. BODILY

Professor, University of Virginia



BEFORE

“Skilling and others have led a transformation in Enron that is as significant as any in business today. ... This is brand new thinking, and there are broad implications for other companies.”

AFTER

“History can't be very kind to it. It's sad: The innovation and ideas and what was good about what they did may be lost in the demise of the company.”

leveraged buyouts. Articulate, handsome, and mature beyond his years, he became Enron's CFO at age 36. In October, 1999, he earned *CFO Magazine's* CFO Excellence Award for Capital Structure Management. An effusive Skilling crowd to the magazine: “We didn't want someone stuck in the past, since the industry of yesterday is no longer. Andy has the intelligence and the youthful exuberance to think in new ways.”

But Skilling's fondness for the buttoned-down Fastow was not widely shared. Many colleagues considered him a prickly, even vindictive man, prone to attacking those he didn't like in Enron's group performance reviews. Fastow, through his attorney, declined to comment for this story. When he formed and took a personal stake in the LJM partnerships that blew up in October, the conflict of interest inherent in those deals only added to his colleagues' distaste for him. Enron admits Fastow earned more than \$30 million from the partnerships. The Enron CFO wasn't any more popular on Wall Street, where investment bankers bristled at the finance group's “we're smarter than you guys” attitude. Indeed, that came back to haunt Enron when it needed capital commitments to stem the liquidity crisis. “It's the sort of organization about which people said, ‘Screw them. We don't really owe them anything,’” says one investment banker.

While LJM—and Fastow's direct personal involvement and enrichment—shocked many, the deal was just the latest version of a financing strategy that Skilling and Fastow had used to good effect many times since the mid-'90s to fund investments with private equity while keeping assets and debt off the balance sheet. Keeping the debt off Enron's books depended on a steady or rising stock price and an investment-

grade credit rating. “They were put together with good intentions to offset some risk,” says S&P analyst Ron M. Baron. “It's conceivable that it got away from them.”

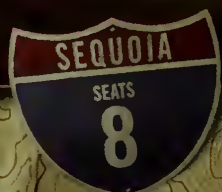
Did it ever. The off-balance-sheet structures grew increasingly complex and risky, according to insiders and others who have studied the deals. Some, with names like Osprey, Whitewing, and Marlin, were revealed in Enron's financial filings and even rated by the big credit-rating agencies. But almost no one seemed to have a clear picture of Enron's total debt, what triggers might hasten repayment, or how some of the deals could dilute shareholder equity. “No one ever sat down and added up how many liabilities would come due if this company got downgraded,” says one lender involved with Enron. Many investors were unaware of provisions in some deals that could essentially dump the debts back on Enron. In some cases, if Enron's stock fell below a certain price and the credit rating dropped below investment grade—once unimaginable—nearly \$4 billion in partnership debt would have to be covered by Enron. At the same time, the value of the assets in many of these partnerships was dropping, making it even harder for Enron to cover the debt.

HIGH HOPES. Skilling tried to accelerate the sale of international assets after becoming chief operating officer in 1997, but the efforts were arduous and time-consuming. Even as tech stocks melted down, Skilling was determined not to scale back his grandiose broadband trading dreams or the resulting price-to-earnings multiple of almost 60 that they helped create for Enron's stock. At its peak in August, 2000, about a third of the stock's \$90 price was attributable to expectations for growth of broadband trading, executives estimate.

That rapidly rising stock price—up 55% in '99 and 87% in



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2000—gave Skilling and Fastow a hot currency for luring investors into their off-balance-sheet deals. They quickly became dependent on such deals to finance their expansion efforts. "It was like crack," says a company insider. Trouble is, Enron's stock came tumbling back to earth when market valuations fell this year. By April, its price had fallen to about 55. And its far-flung operational troubles were taking their own toll. In its much-hyped broadband business, for instance, a capacity glut and financial meltdown made it hard to find creditworthy counterparties for trading. And after spending some \$1.2 billion to build and operate a fiber-optic network, Enron found itself with an asset whose value was rapidly deteriorating. Even last year, company executives could see the need to cut back an operation that had 1,700 employees and a cash burn rate of \$700 million a year.

"SOMETHING TO PROVE." And the international problems weren't going away. Enron's 65% stake in the \$3 billion Dabhol power plant in India was mired in a dispute with its largest customer, which refused to pay for electricity. Some Indian politicians have despised the deal for years, claiming that cunning and even corrupt Enron executives cut a deal that charged India too much for its power.

Enron's ill-fated 1998 investment in the water-services business was another drag on earnings. Many saw the purchase of Wessex Water in England as a "consolation prize" for Rebecca P. Mark, the hard-charging Enron executive who had negotiated the Dabhol deal and other investments around the world. With Skilling having won out as Lay's clear heir apparent, top executives wanted to move her out of the way, say former insiders. A narrowly split board approved the Wessex deal, which formed the core of Azurix Corp., to be run by Mark. But Enron was blindsided by British regulators who slashed the rates the utility could charge. Meanwhile, Mark piled on more high-priced water assets. "Once [Skilling] put her there, he let her go wild," says a former executive. "And she's going to go wild because she has something to prove." Mark spent too much on a water concession in Brazil and ran into political obstacles. She declined to comment for this story.

But if Azurix was a prime example of Enron's sketchy investment strategy, it also demonstrated how the company tried to disguise its problems with financial alchemy. To set up the company, Enron formed a partnership called the Atlantic Water Trust, in which it held a 50% stake. That kept Wessex off Enron's balance sheet. Enron's partner in the joint venture was Marlin Water Trust, which consisted of institutional investors. To help attract them, Enron promised to back up the debt with its own stock if necessary. But if

Enron's credit rating fell below investment grade and its stock fell below a certain point, Enron could be on the hook for the partnership's \$915 million in debt.

The end for Enron came when its murky finances and less-than-forthright disclosures spooked investors and Dynegy. The clincher came when Dynegy's bankers spent hours sifting through a supposedly final draft of Enron's about-to-be-released 10Q—only to discover two pages of damning numbers when the quarterly statement was made public. Debt coming due in the fourth quarter had less than under \$1 billion to \$2.8 billion. Even worse, cash on hand—to which Dynegy had recently contributed \$1.5 billion—shrank from \$3 billion to \$1.2 billion. Dynegy "had

two-hour meeting with the treasurer of Enron, who had been in that seat for two weeks," said a source close to the deal. "He had no clue when the numbers came from."

RESPECT FOR ASSETS. Skilling and Fastow face most of the wrath of reeling employees. "Someone told me yesterday they see Jeff Skilling on the street, they would scratch out his eyes," says a former executive. One of Fastow's lawyers, David B. Gerger, says his client has been the subject of death threats and anti-Semitic tirades in Internet chat rooms. "Naturally people look for scapegoats, but it would be wrong to scapegoat Mr. Fastow," says Gerger.

He confirms that Fastow has hired a big gun to handle his civil litigation: David Boies' firm, which represented the Justice Dept. in its suit against Microsoft Corp. On Dec. 5, Milberg Weiss Bershad Hynes & Lerach filed a suit against Fastow, Skilling, and 27 other Enron executives, saying they illegally made more than \$1 billion off stock sales before Enron tanked. And a source at the Securities & Exchange Commission says four U.S. Attorney Offices are considering whether to pursue criminal

HEAT Four U.S. Attorney Offices are considering whether to pursue criminal charges against Enron and its officers



LAI-D-OFF WORKERS WITH THEIR BELONGINGS

charges against Enron and its officers.

Would the cash squeeze have caught up to Enron, even without Skilling's and Fastow's fancy financing? Credit analysts still argue that the debt would have been manageable absent the crisis of confidence that dried up Enron's trading business and access to the capital markets. But even they have a new respect for old-fashioned, high-quality assets. "When things get really tough, hard assets are the kind you can depend upon," says S&P's Shipman. That's something Enron's whiz-kid financiers failed to appreciate.

By Wendy Zellner and Stephanie Anderson Forest in Dallas with Emily Thornton, Peter Coy, Heather Timmons, Louis Lavelle, and David Henry in New York, and bureau reports



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WHAT THE SHOCKER MEANS

Parsons' steady hand will be needed to navigate treacherous times

Shortly after AOL sealed its deal to buy Time Warner last January, CEO Gerald M. Levin quietly began discussing his succession plans with the board. There was little hint of it in public: If anything, the widely held expectation that Levin would stay on for years as the boss had grown in recent months as he and other executives from Time Warner appeared to be consolidating their control of the merged company. And, by most accounts, the new co-chief operating officer, Robert W. Pittman, 47, a founder of MTV and former disk jockey, would eventually get the nod when Levin left.

It didn't quite work out that way. In a surprise that shocked the media world, the 62-year-old Levin announced on Dec. 5 that he is stepping down.

Equally surprising, Pittman wasn't elevated to the top spot. Instead, Levin ordered up a succession filled with as much potential intrigue as anything his Warner Bros. studio might put on the screen. Levin announced that the company would promote Richard D. Parsons, its 53-year-old co-chief operating officer, to CEO. Pittman's consolation prize: He'll fly solo as COO.

CALM WATERS. Clearly, Levin, AOL Chairman Stephen M. Case, and the board concluded that what the company needs most at the top is a steady hand, not a hotshot media pitchman. The choice of Parsons, a former lawyer and banker known for his courtly manner and diplomatic skills, may calm the waters at a time when AOL Time Warner Inc. faces shifting markets and huge new challenges. The phenomenal success of Warner Bros.' Harry Potter movie aside, pressures are rising in most every business: Ad sales are slumping everywhere, competition is rising for cable and Internet subscribers, and there's a growing face-off with software giant Microsoft Corp.

as the two titans battle to dominate consumer Internet markets.

But if Parsons is cut from a similar cloth as Levin, some changes are still likely. "Jerry was more strategic and cerebral," says Parsons, who oversaw the film, music, and book businesses. "I'm more of a management-by-wandering-around kind of guy. I'm going to make sure we've got the right kind of people in the right jobs."

A BIG JOB TO DO

Parsons is taking over the reins of a mighty media company, but one

FINISHING THE MERGER

The diplomatic Parsons must seamlessly meld Time Warner's creative culture with AOL's aggressive entrepreneurs. And he must graft AOL's online knowhow onto more traditional media assets.

HITTING FINANCIAL GOALS

AOL's credibility was hurt when it overpromised on 2001 earnings, even as the economy tanked. Investors expect Parsons to set more realistic goals—and meet them.

TAKING ON MICROSOFT

With Microsoft's .Net strategy posing direct threat to AOL's core business, Parsons' team will have to break into new markets such as broadband and devices beyond the PC.





JERRY AND DICK

Levin's anointment of Parsons signals that AOL has not rolled over Time Warner

By putting Parsons at the top and Pittman in line to succeed him, moreover, Levin achieved a powerful lineup that should also diminish the sparring between the two sides. Putting two AOL executives, Case and Pittman, at the top so soon surely would have brought deeper fissures between the Internet side and the entertainment and news sides of the empire. "There are an enormous number of different cultures floating around

challenges ahead:

PUSHING BROADBAND

Whether or not AOL wins its bid for AT&T broadband, Parsons will have to rethink its cable strategy. A key piece: building speed Internet connections to stream Warner music and video.

under the surface," says AOL board member Francis T. (Fay) Vincent Jr. "It will take hard work to make it work." Adds Storm Boswick, a fund manager at J.W. Seligman & Co.: "The choice had to be Dick."

"PUBLIC FIGURE." Outside the company, the task will be just as challenging. Much of Parsons' job in recent years has been to negotiate with regulators in Europe and Washington. That experience will come in handy if AOL wins its bid to expand its 13 million-subscriber cable franchise by acquiring AT&T's cable unit. "Dick clearly has a regulatory point of view," says Levin. "He's quite adept at dealmaking. He's made himself a public figure."

And what about Pittman? Some company insiders say that Levin has never been as simpatico with Pittman as he has with Parsons, who was hired in 1995 in part to help Levin articulate a clearer Time Warner message to Wall Street. He has also helped smooth over several internal disputes since then. And in a year on the job, insiders say, Pittman appears to have roiled some executives at former Time Warner units who were turned off by his hard-charging approach and overselling the merger's synergies.

Pittman may have also hurt himself on Wall Street with his outspoken hyping of AOL's extraordinarily aggressive financial targets for the merged company's first year. Even as the economy eroded and ad sales sank over the last 12 months, Pittman and other AOL Time Warner executives clung aggressively to the increasingly unachievable targets, before finally lowering earnings projections on Sept. 24. "I think a lot of investors were turned off by that," says Ajay Mehra, a portfolio manager at Columbia Management, which owns about two million AOL shares.

But Pittman isn't apologizing for those excesses—or anything else in his nearly two years with the Time Warner

team. And he insists he's fully committed to his new job. "Dick and I have proven to be a good team and will continue to do so," says Pittman. "Other than the ego flap of not being named CEO, I am happy to continue as chief operating officer. Dick will be better in the CEO role than I would be, and I told Jerry and Steve that." What's more, he says, when Parsons decides to retire, he will, too. "My biggest CEO successes were at AOL and MTV," he adds.

Maybe, but don't count Pittman out just yet. One highly placed AOL insider says the current thinking is that Pittman needs more experience working with all the divisions before he ultimately takes over from Parsons. "It's a transition thing," says Alan Gerry of Granite Associates, which owns 30 million AOL shares. "Bob is younger than Dick, and his time will come."

But any expectation that AOL's management team would just run roughshod over the slower-moving Old Media execs at Time Warner has clearly proven off the mark. Parsons' elevation is just the latest bit of evidence that Levin's Time Warner underlings have grabbed the levers of power. Former Chief Financial Officer J. Michael Kelly was demoted back to the AOL division shortly after the company announced it would not make its targets. Turner Broadcasting CFO Wayne H. Pace replaced him. Moreover, the once red-hot AOL operations

continue to struggle. "I think AOL is showing it's not all it was cracked up to be," says Mehra. "What is saving this company are Time Warner assets."

Then there's the mystery of Levin. He now says he knew when the merger closed that he would soon move on. And after 30 years with the company, he insists he has accomplished all he can in the business world. The events of September 11, moreover, reopened "the emotional wounds" of his son's tragic 1997 murder. Levin, who majored in biblical studies as an undergraduate at Haverford College, now says he wants to return to earlier interests.

What path his future will take is still unclear. All that's certain is that AOL won't be a big part of it.

By Tom Lowry in New York, Catherine Yang in Washington, and Ronald Grover in Los Angeles



BOB PITTMAN

Hurt by too-rosy financial predictions?

ON MIDEAST PEACE PROSPECTS

“Arafat is not Sadat. He has not been able to deliver anything to the Palestinian people”

There are reports that Vice-President [Dick] Cheney normally your ally, may not share your fervor for going after Iraq. Aren't you and Cheney normally in the same place?

Yeah, we do tend to be in the same place. I don't know of any differences on the Iraq question. But then we have not, as an Administration, taken any position. The reports you refer to are just speculation by people reading the leaves.

Given the escalating violence in the Middle East, is there any hope for the new U.S. peace initiative?

You just can't see that many innocent men, women, and children killed by terrorists and not have your heart break. When it will end, I don't know. Israel does not have a big margin of error. It is a very small country. To have a good negotiation, you need parties that can deliver. The biggest thing delivered [to date] is the agreement between Egypt's Anwar Sadat and Israel's Menachem Begin. They made an enormous step when they signed a peace treaty and transferred a big piece of Israel away. And [Palestinian Authority President Yasser] Arafat is not Sadat. He has not been able to deliver anything to the Palestinian people.

You met with technology executives in the wake of September 11. What's on your mind?

This department used to be the investor that caused the development of some of the most important technological advancements, from the Internet to computers. Today, I doubt that it is. It used to be an advantage to be connected with the [Pentagon] because there would be technology transfer that would benefit the private sector. We've just got to find ways to get connected with the [tech] sector. Maybe there should be some kind of [advisory] board. There are an awful lot of smart people out there.

BusinessWeek online

For an expanded version of Rumsfeld's remarks, go to the Dec. 6 Daily Briefing at www.businessweek.com/today.htm

ON THE RECORD

RUMSFELD ON THE WAR, IRAQ, AND HIGH-TECH HELP

When he took his job, Defense Secretary Donald H. Rumsfeld thought his biggest challenge would be modernizing the military. Instead, he finds himself overseeing the war in Afghanistan for President Bush. On Dec. 4, the Pentagon chief met with Washington Bureau Chief Lee Walczak, Pentagon correspondent Paul Magnusson, and national security writer Stan Crock to discuss the lessons of the war.

The Afghan war has been a blend of high-tech wizardry and low-tech special operations. Already, some analysts conclude that the Pentagon may not need all of the expensive hardware it is seeking, such as 3,000 new strike fighters. Your response?

It is always a mistake to pull one flower and ask what does this say about the garden. We are in Afghanistan. The next thing we do may be totally different. The way our country can best contribute to peace and stability is to have a full range of capabilities.

How confident are you that the

alliance will find Osama bin Laden?

Oh, I think we will. [And] we're not just looking for him. If he were gone today, he has a lot of lieutenants who could carry that fight on. He has activities in 40 or 50 countries. A lot of [al Qaeda] people have been killed, and some have been captured. That's all to the good. But when or how it will all sort through, I don't know.

How long can the U.S. tolerate Iraqi President Saddam Hussein's pursuit of weapons of mass destruction?

Those questions are above my pay grade. We've got 6 to 10 countries on the terrorist list. [Some] already have chemical and biological weapons programs. A number have been pursuing nuclear capabilities. When weapons were less lethal and [casualties] involved thousands instead of hundreds of thousands, or millions, of people, you could make a mistake and it wasn't terminal. [Now] when you're dealing with that many countries and with the close linkages [among] terrorist networks... it forces you to make different calculations.

COMMENTARY

By Rich Miller

INTEREST RATES: IS THE FED FRETTING TOO MUCH?

As the tanking Treasury bond market sent interest rates soaring over the past month, Federal Reserve Chairman Alan Greenspan and his central bank colleagues have begun to work the worry beads. Small wonder. After falling to a low of 4.2% in early November, the yield on the benchmark 10-year Treasury note has now shot back up to 5%; on Dec. 5 alone, the 10-year note suffered its biggest rise in yields since January. The surprise jump has left central bankers fretting that their efforts to get the economy moving again would be stifled—and that they would have to keep cutting short-term rates willy-nilly in response.

Well, it's time to chill out. There's more good news than bad in the run-up in long-term rates. Bond yields had fallen so low partly due to fears of a deflationary meltdown of the economy post-September 11. As the fears dissipated, yields were sure to pop as investors moved money out of safe Treasury securities and into riskier assets such as stocks.

Of course, there's always a risk the markets will overdo it and push long-term interest rates too high, hurting the economy in the process. Mortgage rates, which now play off the Treasury's 10-year note, rose to an average of 7.02% at the end of November, their highest level since July and well above the low of 6.45% set earlier in the month. If mortgage rates rise much further, that could crimp the housing market, one of the economy's few bright spots.

Fortunately, though, the Fed is hardly powerless when it comes to influencing long-term rates. And the good news is bond yields are not being driven higher by fears of inflation. Rather, they're rising on growing expectations of an early, robust recovery next year. That in turn has investors worried the Fed will raise rates sharply next year.

But Fed officials think the market

has got it wrong on both counts. They expect a more muted recovery starting in the middle of the year. And they think market expectations of 150 basis points or more of Fed tightening in 2002 are overblown. To the extent they can convince the market that its fears are overblown, that will help cap long-term rates.

POSITIVE SIGNS. On the whole, the bond market action over the past month should provide some comfort to the Fed. After the September 11 attacks, Greenspan grew worried investors would hunker down and shun risk, parking their money in safe Treasury securities. Those fears haven't been borne out. Indeed, as Treasury yields rose through much of November, junk-bond yields fell because investors were betting the Fed's monetary medicine and a big dose of fiscal stimulus would rapidly revive the economy and limit defaults. Investors poured some \$1.8 billion into junk-bond mutual funds in November, according to Martin Fridson, high-yield strategist at Merrill Lynch & Co. That's up sharply from \$1 billion in October.

In another sign of confidence, companies have sharply stepped up their issuance of corporate bonds. To clean up their balance sheets and raise money for future expansion, corporations tapped the bond market to the tune of \$73 billion in October and \$56 billion in November,

according to Standard & Poor's Corp. That's good news for the economy, even if the higher supply of bonds pushed prices down and yields up.

Other technical factors, such as forced selling of interest-rate futures by beleaguered energy giant Enron



Corp. and shifting hedging strategies by mortgage lenders like Fannie Mae, also played a role in the November run-up in bond yields. But as those factors have faded, they're no longer placing significant pressure on yields.

Fed officials are also doing their part to bring yields down. On Nov. 27, the normally hawkish Fed Governor Laurence H. Meyer triggered a big rally in the bond market when he said the economy still wasn't out of the woods. That sent a signal that the Fed is ready to cut rates at their next meeting on Dec. 11. The quick response—yields fell a quarter percentage point in just a few days—showed the Fed hasn't lost its touch with bond investors. The bottom line: Signs of a reviving economy mean long-term rates are unlikely to revisit their post-attack lows. But, provided the Fed plays the markets right, neither will rates set off on an upward tear that hurts the economy.

Miller covers the Fed from Washington



COMMENTARY

By Steve Hamm

TECH: NOT MUCH OF A WAVE IN SIGHT

It has been an abysmal 12 months for technology companies. A year ago, PC maker Gateway Inc. signaled the beginning of the tech bust when it revealed that Thanksgiving weekend sales ran 30% less than expected. During the past few weeks, however, there's been a steady drumroll of upbeat news heralding what seems like renewed life in tech land. Indeed, it looks like the long decline in the tech sector may finally have hit bottom. But does that mean the long-awaited tech turnaround is at hand? Well, probably not for a while.

True, there's been no shortage of good news of late. It started modestly in early November, when Cisco Systems Inc. reported a 3% revenue increase over the previous quarter. A few weeks later, Hewlett-Packard Co. announced that it sold 20% more PCs in stores this Thanksgiving weekend than last. And on Nov. 29, the Commerce Dept. said that orders for computers and semiconductors are coming in at a slightly higher rate than shipments going out. Even demand for memory chips has increased enough that the biggest producer, Korea's Samsung Electronics Co., raised prices by 10% on Dec. 5. Moreover, surveys of corporations show that they may buy more software and computers in the coming months.

"BUBBLE II." These signs of life have investors scrambling to get in on the action. Technology indices are up 50% or more since late September, and some tech companies have fared even better. Both Intel Corp. and Sun Microsystems Inc. have seen their shares soar more than 60% over the past two

months. But that's putting tech stocks back into troublesome territory. The forward price-earnings ratio for the top 100 tech companies is now perched at 43, just below its all-time peak of 47. "It feels like Bubble II," warns

Edward Yardeni, chief investment strategist at Deutsche Banc Alex. Brown.

Problem is, the excitement is premature. While a bottom may be at hand, it's too early to predict when the engine that powered the 1990s boom will be ready to start chugging again. The tech sector is still only using 61% of its manufacturing capacity. Until a major corporate buying spree kicks in enough to push utilization up to 80% and above, profits will remain anemic.

Don't expect those factories to fill up anytime soon. Info-tech spending increases of 9.4% in 1999 and 11.1% in 2000 were fueled by a rare combination of Internet hoopla, worries over Y2K, and unparalleled economic growth. But tech spending is expected to contract by 3% this year and only grow 4% next, according to market researcher IDC. "The risk here is that you end up bumping along the bottom for a while," says Merrill Lynch & Co. technology strategist Steven Milunovich.

For corporate IT buyers to get back into the market in a big way, they will first have to record their own improved profits, and that probably won't happen until midyear at least—

when their cost-cutting moves take effect and demand for their products and services starts to climb. Some major consumers of technology—airlines, insurance companies, and even tech companies themselves—may delay their purchases even longer. Says Lawrence J. Ellison, chairman of software maker Oracle Corp. "I believe we'll start seeing some growth in the next year, but I can't forecast any closer than that."

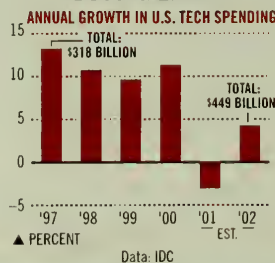
LOW GEAR. Things remain even bleaker in the telecom industry, one of the biggest buyers of tech gear. Telecom accounts for 10% of all IT purchases. Now, Merrill Lynch expects capital expenditures for U.S. carriers to decline 12% this year, 20% next year, and another 6% in 2003. Sprint Corp. alone will cut capital spending 30% next year because of slack demand.

When demand does strengthen, analysts expect companies will spend their IT budgets on wireless communications, supply-chain management software, and basic Internet gear that will help them keep ahead of their competition. But even then, no one is looking for a return of '90s-style boom times. With-

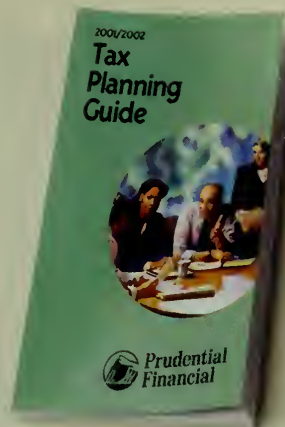
out major new innovations to drive demand, like the Internet and PCs did in the '90s, growth in the tech sector is likely to remain in low gear for most of 2002. Still, that would be a far cry better than the truly dark days of 2001.

With Ben Elgin and Jim Kerstetter in San Mateo, Calif.

TECH MAY HAVE BOTTOMED OUT



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THE WORKPLACE

A SOCK IN THE EYE FOR LABOR

Unions took an especially heavy hit from September 11

Like many other Americans, labor leaders are worried about the recession and the economic fallout from September 11. Gathering in Las Vegas for the AFL-CIO's biennial convention the week of Dec. 3, they had plenty to fret about. Indeed, unions have more cause for concern than most, since the events of 2001 have battered them harder than almost any other group in the country. No one is more upset than AFL-CIO President John J. Sweeney, who has been losing his six-year crusade to inject new life into the U.S. labor movement.

Of the 760,000 or so job cuts announced since September 11, the AFL-CIO estimates that roughly 50% have involved union members. That's nearly four times organized labor's 13.5% share of the U.S. workforce. The loss comes largely because unions are disproportionately employed in the hard-hit airline and aerospace industries. And even before September 11, the economic downturn struck first and hardest in manufacturing, another labor stronghold. That too has whacked tens of thousands of union jobs.

All of which is making Sweeney's

task much harder. True, union membership had stopped its decades-long free-fall during the boom years. And some unions—particularly auto workers racing to produce record numbers of vehicles—have yet to take much of a hit. But the current broad meltdown wipes out any prospect of real growth in labor's ranks. The loss of dues-paying members will also crimp union budgets, making recruitment efforts more difficult. It could make bargaining harder, too, if it emboldens management in recession-hit industries to demand greater concessions. Sweeney, who was due to be reelected to another four-year term on Dec. 6, vows to redouble his efforts. "If we're confronted with heavier layoffs, we'll just have to make more efforts to organize new members," he says.

Still, the setback sheds a harsh light on just how much difficulty Sweeney has had in prodding lumbering unions to change. Ever since he took office in 1995, Sweeney has told unions that they will grow again only if they drastically overhaul their approach. He argues unions must devote at least 30% of their budgets to recruitment, up from the less than 5% typical today.

But most unions still haven't made the tough decision to shift resources from servicing current

CRAPPED OUT IN LAS VEGAS: The AFL-CIO's Sweeney meets laid-off workers

members to recruiting new ones. Just of the 66 unions the AFL-CIO have increased their ranks the past two years

according to federation figures. Some this growth stemmed from union members or from hiring by already unionized employers during the late-1990s expansion. Elections to vote on union representation haven't increased since 1990. Only a dozen or so unions focus on organizing, AFL-CIO officials say, and many of those had been doing so before Sweeney took office. "Except for a few unions, the commitment is still not there," says former AFL-CIO Organizing Director Richard Bensinger, who now consults with several unions.

STEEL-GRAY. Labor's prospects aren't likely to brighten while the economy remains in the doldrums. Unions representing public employees are bracing for layoffs caused by shrinking state budgets, says Service Employees International Union President Andy Stern, who represents many of those workers. At the same time, the pressure on manufacturing, where labor still has above-average membership, shows scant sign of a turnaround. More jobs will be lost, for example, if the steel industry is allowed to consolidate, as USX Corp. and Bethlehem Steel Corp. called for on Dec. 4. Unions also may lose ground if sales turn down in autos, as many expect.

The pressure to bring down labor costs will continue, too. "Even when the pickup comes, there will be a lag before the [wage] concession demands slow, as companies wait to see if it's real," says

Patrick J. Cleary, human resources vice-president at the National Association of Manufacturers.

Much of labor's growth since 1995 has come among public workers, who had been signing up for years before Sweeney took over. Private-sector unions have generally failed to capitalize on the prosperity of the late 1990s, when jobs proliferated and cost pressures were at a minimum. Now the job of union building will only get tougher.

By Aaron Bernstein in Washington

UNION BLUES

Where the terrorist blows fell hardest:

HOTEL WORKERS Nearly 80,000 of the union's 275,000 members have lost their jobs.

MACHINISTS The airlines and Boeing have cut 50,000 of the union's 450,000 jobs—on top of 20,000 other losses this year.

STEELWORKERS Mills have laid off 15,000 of 660,000 members this year. A further 6,000 may go if bankrupt LTV liquidates.

PUBLIC EMPLOYEES Shrink- ing city and state budgets are likely to bring more layoffs.

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BASEBALL

LOOK AT THAT LINE OUTSIDE FENWAY

A record price tag doesn't faze bidders for the cursed Red Sox

Never mind the recent pronouncement from Major League Baseball Commissioner Bud Selig that the big leagues, overbuilt and losing money, must cut two teams. What's really making waves in baseball these days is the first sale of the Boston Red Sox since the Depression. No fewer than six groups submitted bids on Nov. 29. Among those joining the bidding: ex-Baseball Commissioner Peter Ueberroth, ex-Senate Majority Leader George J. Mitchell, Cablevision Chairman Charles Dolan, and New York Times Co.

The prize won't come cheap. Industry insiders expect the Sox to fetch \$400 million or more. That easily eclipses the \$320 million paid for the Cleveland Indians in 1999. In addition to a controlling 53.5% stake in the team, the winner would get 11 acres of land in and around historic Fenway Park and control of New England Sports Network, the cable channel that broadcasts the team's games.

BALLPARK FIGURES. And that's just a start, since "\$400 million is only likely to get the new owners to first base," says David F. D'Alessandro, CEO of John Hancock Financial, a sponsor of Major League Baseball. To do the deal, the winner may have to buy out some of the team's limited partners. D'Alessan-



ENDANGERED LIST: Fenway Park faces renovation or razing

dro figures that could cost \$300 million.

Plus, to really make money, the new owners must quickly come up with a plan for Fenway. The options: Renovate the fabled park, or build a new stadium elsewhere. Either way, the challenge will be coming up with a design that includes such revenue-enhancing goodies as more luxury boxes without losing the charm and scale of the old place. It'll be pricey: Red Sox CEO John L. Harrington's 1999 aborted plan to build a new park came in at \$545 million.

Add it all up, and Ganis says the cost of acquiring the Sox could approach \$1 billion. That may sound like a high price for a team, dogged by failures, that

hasn't won a World Series since 1918. But the loyalty of fans, combined with the competitive bidding, should he command a multiple of at least 2.5 times revenues, says Andrew Zimbalist, Smith College economics professor and baseball expert. He estimates that Fenway, the Sox brought in \$160 million in 2001; in a modern stadium revenue could rise to \$200 million annually. The

would make the team alone worth \$500 million. There's NESN. John Mansel, a cable-sports analyst at Kagan World Media, figures it's easily worth an additional \$200 million.

RISK FACTORS. Bidders look to be of three types. First are those poised to build a new stadium because they own land nearby. A group led in part by Boston developer Steven Karp has the best local political ties, including with the team's limited partners. A second is headed by a smaller local developer, Frank McCourt.

Another set of bidders aims to maximize revenues from NESN. They include Cablevision's Dolan, who

may have the deepest pockets and could give the Sox national TV exposure.

Finally, some simply want the team itself. A top contender here is the group headed by TV producer and ex-San Diego Padres owner Tom Werner. His allies include Mitchell and New York Times Co., the owner of *The Boston Globe*. The latter could use the Sox to promote its interests in New England. Werner's group, which has the closest ties to other owners, would renovate Fenway.

Picking the winner will take more time. Harrington, the trustee of the Jean R. Yawkey Trust—which owns the controlling stake and is holding the auction—has said he'll favor the high bidder. Most believe he'll ask for a second round of bids to drive up the price. But he'll have to take into account the views of the limited partners and other owners, as well as Selig.

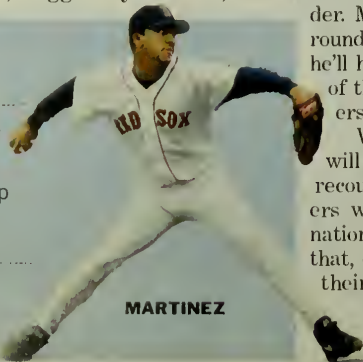
Whoever wins, the ramifications will extend far beyond Beantown. To recoup their investment, the new owners will have to market the Sox on a national basis, says D'Alessandro. And that, of course, assumes they can break their losing streak.

By William C. Symonds in Boston, with Tom Lowry in New York

BATTLE IN BEANTOWN

Among the potential buyers for the Boston Red Sox:

- ▶ TV producer Tom Werner leads a group that includes New York Times Co., owner of *The Boston Globe*
- ▶ Local investors headed by developer Steven Karp and Joseph O'Donnell, CEO of Boston Concessions Group, which services stadiums
- ▶ Charles Dolan, chairman of Cablevision Systems, and John McMullen, former owner of the Houston Astros



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LINCOLN
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COMMENTARY

By Joan O'C. Hamilton

GINGER CAN'T RUN ON HYPE ALONE

Six months ago, I think I would have greeted the literal rollout of inventor Dean Kamen's oddball new über scooter Segway with a snarl. For one thing, the unveiling was so heavily orchestrated, complete with "exclusives" in major media—including a lengthy piece in *Time* and an unveiling on *Good Morning America*. A suspicious leak set the tech world ablaze last year with rumors about Kamen and his invention. It was going to be bigger than the Internet, in one version. Other stories claimed that Apple Computer co-founder Steven P. Jobs got an early peek and made the wacky prediction that cities would redesign themselves around the device. (Jobs denies he ever said this.)

Handsprings made their debut as a nice but ho-hum Palm clone.

Obviously, there is an inevitable letdown now that the scooter's out of the bag. It's hard to imagine that its future for consumers is anything but a novelty. It's too bulky to be practical in crowded situations, too minimalist to carry what most people

need in their daily journeys.

I've spent too many hours with baby strollers at Disneyland to imagine vast numbers of people navigating and parking anything this size in a convenient way. The chat board yammering that for so long focused on whether Segway, developed under the code names IT and Ginger, would be hydrogen-powered or involve

enterprise solution to a problem you never knew companies had! Presumably, no animals were sacrificed to make it. Private backers who could afford it foot the bill, and it looks like there may be some cool industrial and public-sector applications. It was nice to hear postal workers will get to be part of an early trial—there's a crowd who could use some fun these days.

Big, bold, new products you can touch, see, and enjoy using come along rarely in this information economy. What fun to have an outfit stick its neck out and give us something interesting. As the world lurches from the fallout of September 11,

Kamen's scooter may not live up to its billing, but it's a fun American gizmo, and those are rare these days

And Kamen himself told *Time* that the Segway "will be to the car what the car was to the horse and buggy."

It was reminiscent of a few other top-secret, but bound-to-disappoint, projects in recent years. Recall, for example, the much-bally-hooded Hand-spring Visor two years ago. Handspring Inc. was also bankrolled in part, as is Segway, by Silicon Valley venture capitalist John Doerr, and big claims attended its gestation. However, a rush to market meant the original

jet packs has shifted to prosaic arguments like whether overweight Americans need a device that will limit their exercise even more.

TRIALS. But frankly, the more I've thought about it, the more I think: Oh, good for you, Dean. Nothing gets high tech's heart—maybe even America's—racing like a nifty new piece of hardware.

How refreshing to contemplate an offering that doesn't involve a Web-based, back-office

events in the Middle East, and the recession, it seems clear the technology march we thought was unstoppable is a luxury of a relatively peaceful economy. Maybe this gyroscopic personal transporter can help us turn a corner and inspire us to embrace new things again, instead of holding on with white knuckles to what we've got.

In the long run, all the hype will make life toughest for Kamen himself, increasing pressure on him to deliver. But truth is, *Good Morning America* co-hosts Diane Sawyer and Charley Gibson's giggles and grins seemed genuine as they chugged around Bryant Park on their Segways. It was nice to see a silly scene in New York again—and to let your imagination roam in all sorts of mercifully harmless directions.

Hamilton writes the Digital Lifestyle column for BusinessWeek e.biz.





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Agilent Technologies

dreams made real

EDITED BY MONICA ROMAN

THE GAVEL FALLS ON SOTHEBY'S

ON DEC. 5, A JURY FOUND former Sotheby's Chairman A. Alfred Taubman guilty of conspiring with archrival Christie's to fix auction prices. Taubman, 76, insisted that the scheme had been cooked up and executed by former CEO Diana "DeDe" Brooks. She previously pleaded guilty to price-fixing but said she was acting on behalf of her boss. The ex-chief now faces up to three years in prison, while his Christie's counterpart in the secret meetings, Anthony Tennant, is safe in London. At least Taubman, a former shopping-mall developer who remains the auction house's controlling shareholder, can take comfort in one thing: Perhaps relieved that the controversy is now resolved, investors bid up Sotheby's shares 13% on the news, to \$15.67. Sotheby's has already pleaded guilty to an antitrust charge, which carried a \$45 million fine, and has

paid millions more to settle customer claims.

THE SUPER BOWL'S SUPER AD DROP

AD SALES FOR FOX'S FEB. 3 Super Bowl could use a last-minute touchdown. Advertising buyers say Fox hasn't yet sold about 30% of its slots for the pro-football championship, usually the hottest ad buy on network TV. Sacked so far by a lackluster ad market, Fox is asking \$1.9 million for a 30-second spot. That's down from the \$2 million it had been seeking prior to September 11—and a steep decline from the \$2.3 million that CBS got for last season's big game. Longtime sponsors PepsiCo and Anheuser-Busch have already signed on for Super Bowl spots, along with newcomers Levi Strauss and MasterCard.

TOUGH TIDINGS AT CNA

TROUBLED CNA FINANCIAL is cutting some 1,850 jobs—10% of its workforce—in a long-expected reorganization of its property-casualty and life-insurance operations. The company on Dec. 5 said that it would record a fourth-quarter charge of up to \$124 million after taxes as it shrinks from 169 offices to 68 around the country. CNA suffered a \$304 million loss in the September 11 World Trade Center attack, which led to a net operating loss of \$155 million in the third quarter, but analysts say its restructuring was needed long before then.

WHEN PRO FORMA IS BAD FORM

COMPANIES, BEWARE: THOSE popular "pro forma" financial statements could land you in hot water with the Securities & Exchange Commission. The

HEADLINER: WILLIAM FORD

ROAD TEST

THE JOB JUST KEEPS GETTING tougher for new Ford Motor Chief Executive William Ford Jr. On the job just a month, he has seen a worsening economy drive up auto-loan defaults at the company's Ford Motor Credit financial subsidiary, while cutthroat competition ratchets up marketing costs.

That led the company on Dec. 5 to warn investors it expects a 50¢-a-share operating loss in the fourth quarter, instead of the 10¢ Wall Street was anticipating. Earlier in the week, the auto maker announced it will eliminate one shift

at its Edison (N.J.) truck plant, reduce retirement and health-care benefits for 45,000 salaried workers, and suspend merit raises for top managers.

Meanwhile, Bill Ford is preparing to unveil a major restructuring in mid-January.

"We're reviewing this entire company top to bottom, and bottom to top, to figure out what's critical and what's not," he told reporters recently. "If it's not, let's get rid of it." Unfortunately for investors, that could mean additional one-time charges to those already hard-hit fourth-quarter results.

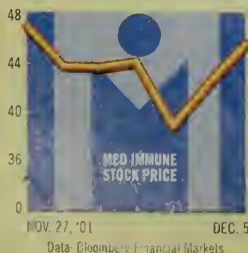
Katie Kerwin



CLOSING BELL

ONE FLU OVER

MedImmune's Dec. 3 announcement that it would buy Aviron, developer of a flu vaccine, sent its stock down 12%, to \$38.83, on concerns that the \$1.5 billion deal is expensive and won't pay off quickly. But by Dec. 5, the company's share price had rebounded by 17.7%, buoyed by the vaccine's long-term potential.



SEC warned on Dec. 4 that it will launch fraud investigations if pro forma numbers are misleading or omit information that's important to investors. Pro forma results, which deviate from generally accepted accounting principles, have become increasingly popular with companies and analysts, who argue that official numbers don't reveal enough. SEC Chairman Harvey Pitt allows that he sees the flaws in GAAP—but doesn't want companies manipulating numbers to hide poor results.

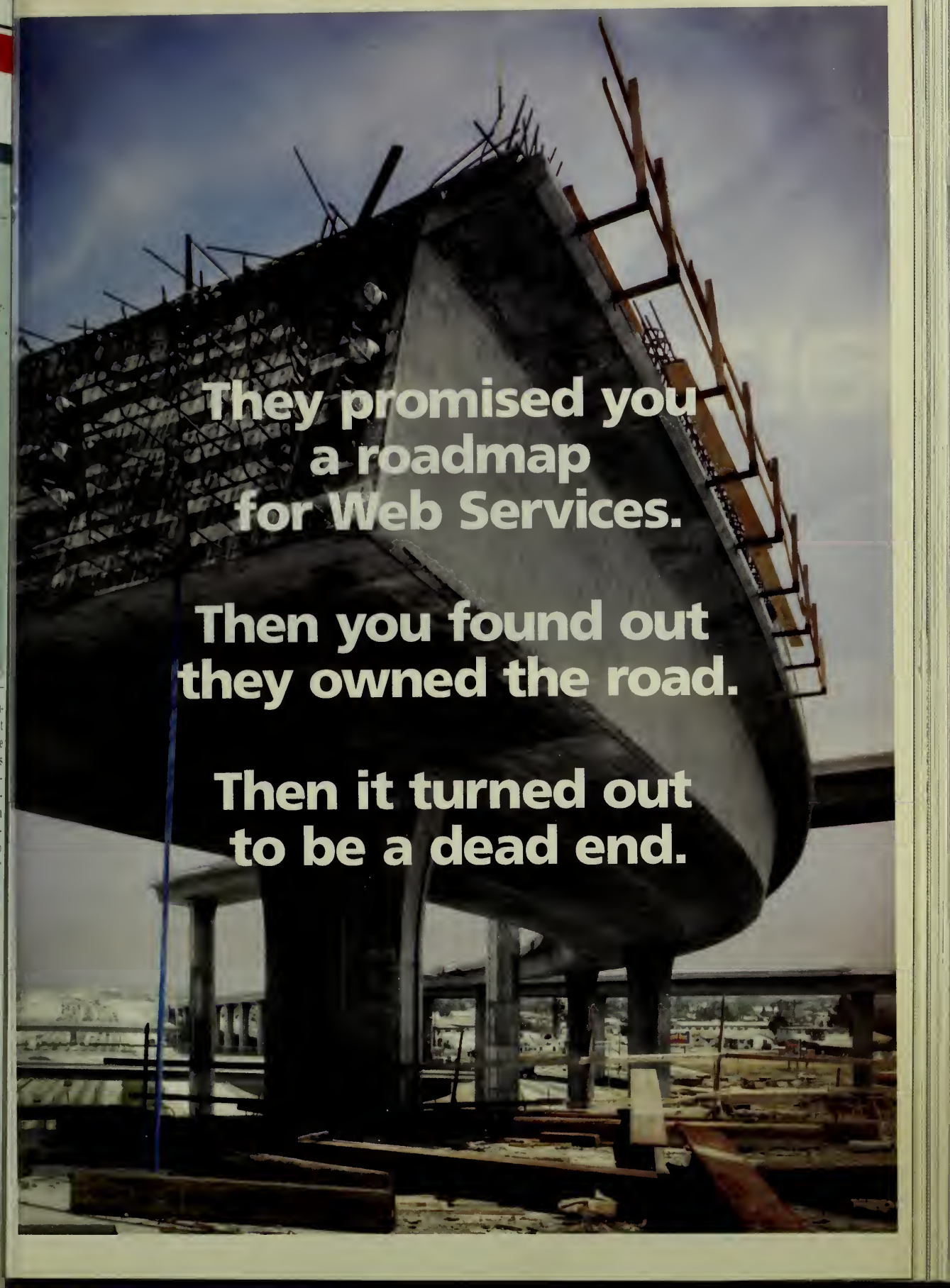
MICRON: HANKERING FOR HYNIX

MICRON TECHNOLOGY WANTS a memory boost. The Boise (Idaho) maker of memory chips for PCs is in talks to form an alliance with—or purchase—ailing South Korean competitor Hynix Semiconductor. A deal could give Micron control of more than

50% of the dynamic random-access memory-chip market and help insulate it from the boom-to-bust cycle that has long plagued the chip industry. Although there are incidental signs of a recovery in the PC market, memory chip-makers have been forced to sell supplies well below their cost because of excess capacity. The deal could help resolve that. U.S.-South Korean friction over trade and Hynix' \$7 billion debt load, however, mean that an eventual pairing is far from a sure thing.

ET CETERA...

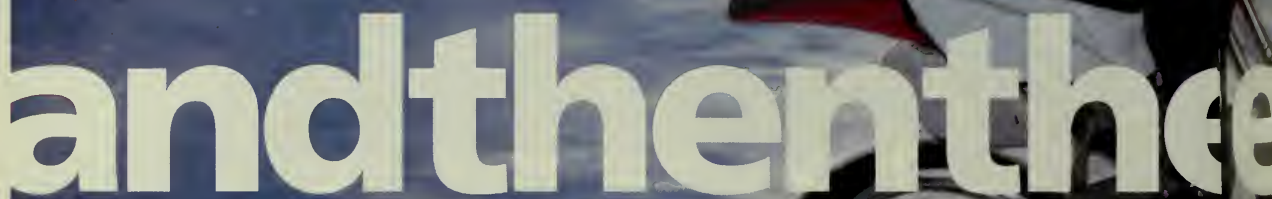
- Ames Department Stores will close 54 stores to help it emerge from bankruptcy.
- Delta Air Lines said its November traffic fell 20.1% from the year-ago period.
- The Nasdaq Stock Market will begin paying brokers for price data on their trades.



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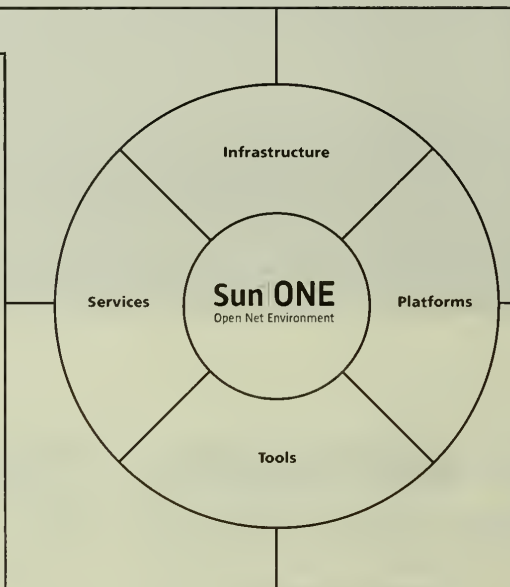
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RICHARD S. DUNHAM AND LORRAINE WOELLERT

A BUSH RECESSION? FOR THE DEMS, THE RIGHT WEAPON AT THE WRONG TIME

It's a hard time to be a hard-charging Democrat. After all, the man derided by Dems as a Presidential pretender just a year ago now wins near-unanimous support for his response to the September 11 attacks. So with the 2002 election season about to start, what's an opposition party to do? How about: change the subject.

Convinced that the floundering economy could eventually become the Republican Party's Achilles' heel, Democratic leaders have been refocusing public attention on Bush's fiscalewardship and GOP favors for corporate interests. In recent weeks, Senate Majority leader Tom Daschle (D-S.D.) has delayed action on an economic stimulus plan to give Dems time to blast the hefty business tax breaks and modest worker assistance backed by Republicans. Democratic Congressional Campaign Committee Chair Nita M. Lowey (D-N.Y.) raised the rhetoric several decibels higher on Nov. 29, blaming Bush for the recession and labeling his refusal to spend more on homeland security "unpatriotic."

But their blunt approach carries significant risks as Democrats seek to retain control of the Senate and regain the House. Strategically, their timing is problematic on two levels: With the election 11 months away, it's the public mood next fall—not this holiday season—that matters. Moreover, signs of recovery in some sectors could take the punch out of the Dems' message.

"This is not a debate we want to have right now," warns one high-ranking Democratic operative. "If we get involved in a fight with a popular President, we can only lose." Not only is the strategy suspect, but the Dems' tactics—such as questioning the President's patriotism in the middle of a war—have been downright suicidal. The shrillness of the attack goes against the advice of top strategists like hyperpartisan James Carville, who warned in a Nov. 13 memo

that Democrats need to support Bush's wartime efforts and "set a tone that lacks a sharp partisan quality."

Now, Republicans have been able to muster their righteous indignation and change the subject once again—from the economy to Democratic tactics. National Republican Campaign Committee Chairman Thomas M. Davis III (R-Va.) called Lowey's remarks "shameful" and accused her of trying to "undermine our national unity." With Democrats attempting to regroup, a more conciliatory Daschle on Nov. 27 backed

off on demands for an additional \$15 billion in homeland security spending. Meanwhile, the DCCC has abandoned a plan to use Bush's name in negative ads and has scaled back a media blitz. Lowey was unavailable for an interview, but DCCC board member Robert T. Matsui (D-Calif.) says his party has an obligation to highlight Republican economic priorities. "The public supports the President and supports bipartisanship," Matsui says, "but people are concerned enough about the economy that they want us to talk about it."

TAX MATTERS. Blunders aside, the economy still could be the top Democratic weapon in 2002. Several recent polls show a growing concern about the recession, particularly among swing voters and independents. And Americans are more receptive to Democratic stimulus proposals—such as increased aid for the unemployed, massive government spending for construction projects, and postponing tax relief for the wealthiest—than to a GOP package that tilts heavily toward business. "The importance of the economy to the 2002 elections is hard to overstate at this point," argues analyst Karl Agne of Democracy Corps, a Democratic polling and strategy group.

Maybe so. But as the Dems are learning, playing the economic blame game with a wildly popular wartime President can backfire faster than you can say "rally 'round the flag."



LOWEY: Shrill attack

CAPITAL WRAPUP

THE BUSH-MICROSOFT TEAM

► Those frosty relations with the Clinton White House seem like ancient history at Microsoft. A month after settling its antitrust case, the Bush Administration has turned to Microsoft for help in homeland defense. Richard A. Clarke, special Presidential adviser for cyberspace security, has picked Microsoft Chief Security Officer Howard Schmidt to help design strategies to protect U.S. computer systems from hack attacks by al Qaeda or other terrorist groups.

PRIVACY: DOUBLE STANDARD

► The just-passed bill funding the Treasury Dept., Postal Service, and White House includes a provision banning federal agencies from collecting personally identifiable information gleaned from any individual's use of a federal Web site without permission. The feds are also barred from buying such info on nongovernment sites. But while Congress wants to shield citizens against government snoops, it has no such qualms when private companies collect the data.

SPECTRUM STANDOFF

► Now is not the time to ask the Federal Communications Commission to sell you some unused spectrum. After all, the Defense Dept. controls a large part of the airwaves coveted by the wireless industry, and the generals aren't likely to surrender spectrum space in wartime. But that hasn't stopped the Telecommunications Industry Assn. from taking a new tack. The TIA's new idea: set aside a swath of unused airwaves for emergency government communications around the world.



THE WAR ON TERROR

CHARLOTTE BEERS' TOUGHEST SELL

Can she market America to hostile Muslims abroad?

What's wrong with this picture? While the U.S. racks up victories against the Taliban on the dusty Afghan battlefield and tightens the noose on Al Qaeda terrorists, young Pakistanis buy Osama bin Laden T-shirts, the European left tut-tuts over the U.S. bombing, and Arabic language newspapers and broadcasts excoriate Washington as a willful bomber of civilians and an enemy of Islam.

Disturbing, to be sure. And to Charlotte Beers, the former Madison Avenue top gun hired by Secretary of State Colin L. Powell to refurbish America's image abroad, "it's a pretty awful thing to have to read early every morning." But poring over hostile transcripts and

headlines culled by U.S. embassies has not discouraged Beers. "The whole idea of building a brand is to create a relationship between the product and its user," she explains during an interview in her modest Foggy Bottom office. "We're going to have to communicate the intangible assets of the United States—things like our belief system and our values." And, she adds, skills she honed during four decades in advertising have prepared her for the task.

There's no arguing that Beers, 66, has faced up to major marketing challenges. She capped her career by heading Ogilvy & Mather and J. Walter Thompson, two of the world's advertis-

BEERS

One critic wonders if you can peddle Uncle Sam like Uncle Ben's

ment and her \$500 million, mid-1990s campaign to help IBM shake its rep as an arrogant, out-of-touch powerhouse.

Recasting the image of the U.S. in the Middle East, however, promises to be much tougher than making Big Blue seem cuddly. After all, in too many Islamic nations, state-controlled media outlets and fundamentalist schools called *madrasas* have inundated young people with virulent anti-American messages for more than half a century.

SEAMLESS PITCH. On the home front Beers will have to navigate the rocky congressional budget process to secure more money for her epic public relations battle and ensure that support doesn't wane when the bombs stop falling. Some experts are skeptical. "I'm not sure what an ad person brings to public diplomacy in a time of war," sniffs William J. Drake of the Carnegie Endowment for International Peace. "I just find the notion that you can sell Uncle Sam like Uncle Ben's highly problematic."

The criticism harks back to Beer's first major advertising victory when, in her 20s, she became the only female product manager for Uncle Ben's rice. As she moved up the ranks, Beers's penchant for flamboyant outfits and her charming, even flirtatious, personality set her apart in the male-dominated advertising world. She was known to greet CEOs as "honey" and "darlin'" and occasionally referred to IBM CEO Lou Gerstner as "that adorable little man." Once, Beers wowed Sears Roebuck executives by taking apart and reassembling a power drill as she seamlessly delivered a pitch for their business. (Her personal life has pizzazz, too: Friend Martha Stewart is said to have helped Beers plan her wedding to her third husband, millionaire art dealer William Beadleston.)

Some former colleagues say Beers's talents lay in wooing work rather than conjuring up creative campaigns. "I could name 20 or 30 people who are better marketing strategists," says the head of a Mad Ave. firm. "But Charlotte is quite the diplomat, and if a lot of this job is politicking, she'll be great at that."

Since being confirmed on Oct. 1, Beers has acted quickly to address one glaring problem: the lack of a U.S. spokesman on Qatar-based Al Jazeera, the widely watched Arabic-language satellite-tv

annel. She hired as her senior adviser former Ambassador Christopher Ross, a fluent speaker of Arabic who had been stationed in Syria and Algeria. When bin Laden's second taped diatribe surfaced, Ross rebutted the allegations pointing the finger on Al Jazeera.

Beers also has been meeting with prominent Muslim Americans to gauge which messages might promote a more positive image of the U.S. Further plans call for marketing research into how best to connect with younger Muslims. Once the research is done, Beers will enlist former Mad Ave. colleagues to help craft a propaganda campaign. And with whole swaths of the world viewing the sole remaining superpower with unbridled hostility, Beers doesn't intend to stop with the Middle East.

So far, Beers's biggest rollout was a booklet designed to hammer home the

ON CHANGING MUSLIM MINDS



AN
AFGHAN
REFUGEE
BOY

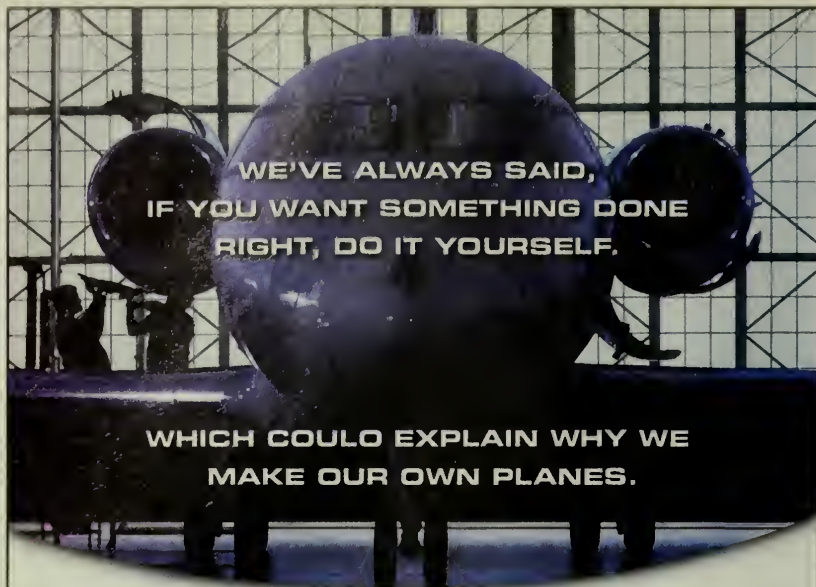
“The government [can] give you research in terms of major policy issues. But they're not going to tell you much about what will help you talk to a 14-year-old boy who has been inculcated for years with a really different vantage point about what matters...”

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Government

depth of the September 11 carnage and bin Laden's role in the attacks. The brochure, laced with grisly photos of the attack, was distributed to Mideast countries, sometimes as a supplement in newspapers. But more ambitious projects are in the offing. Beers is considering TV and radio spots in which sports stars and celebrities talk up the U.S. "LESS AND LESS." Of course, even if the Under Secretary finds popular Muslim allies to sell American values, simply getting the word out will be difficult in countries where the media is controlled and largely hostile. So far, Congress is cooperating—setting aside about \$3 million in year-end spending bills to create a new radio network that would broadcast throughout the region.

But coaxing pols to make good on promises to fatten her budget will play a large role in determining Beers's success. The end of the cold war saw the shuttering of many overseas media centers.

ON COMMUNICATION

“Countries like the United States, which are big and powerful, will always translate into arrogance if there is no dialogue. And how much dialogue did we have with Afghanistan?”

ters and exchange programs that existed to explain America to the world. “For years we’ve talked about doing more with less,” says Barry Fulton, a former State Dept. hand who now heads the Public Diplomacy Institute at George Washington University. “In fact, we’ve just ended up doing less and less.”

Beers pretty much acknowledges that the job she signed on for is considerably more difficult than reassembling a power tool without dropping a screw. “This is a tricky business,” she says, adding that some of her efforts may backfire. But as Beers told the international press corps last month, the U.S. will press ahead with the propaganda war all the same: “Consider the alternative, which is silence. We have no choice.”

*By Alexandra Starr
in Washington*

SPECIAL ADVERTISING SECTION

LEADERSHIP FROM HEIDRICK & STRUGGLES

A GUIDE FOR LEADERSHIP SUCCESS



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The Leadership Company

WHEN TIMES ARE TOUGH, SMART COMPANIES INVEST IN

{People}

BY JUDY OLIAN

Now that the economy is officially retracting, there's no doubt that companies face incredibly tough choices for survival, including the decision to lay off employees. Inevitably, however, some organizations go too far in tough economic times, indiscriminately cutting workers without regard for long-term strategic success.

BENEFITS OF COUNTER-CYCLICAL HIRING

Some companies should seize the opportunity to hire workers during times like these. Counter-cyclical hiring may offer unique competitive advantages. In a recent study, academics from Texas Christian University, Oklahoma State University, and Creighton University showed that companies that go against the herd and hire key managers and professionals during economic downturns—the equivalent of a contrarian investment strategy—demonstrate stronger financial performance. The payoff, in terms of enhancing shareholder value, typically occurs one to two years later.

Few companies take advantage of the opportunity to invest in their people during a downturn. At a minimum, firms should do everything to hang on to their key strategic assets, such as the sales force, product and quality engineers, and design teams. These are the people who will position the company to take off when the business cycle turns around. Retaining experienced people in

these areas is critically important for sectors struggling to rebuild, such as the auto industry, which recently announced widespread layoffs. Unless these cuts are made with a discerning eye that focuses on long-term market needs, they may exacerbate the industry's problems. In fact, a study by Bain & Co. found that companies announcing mass or repeated layoffs during the 1990-91 recession under-performed the market over a three year period.

With other companies shedding themselves of talented professionals, counter-cyclical hiring provides a window of opportunity to snare the very best and brightest, stars who might not be available during a healthier cycle. There is also an opportunity to build for diversity, given the greater availability of scarce minority and female talent.

BREEDING LOYALTY

Other counter-cyclical practices provide companies advantages as well.

Some well-known companies, including Southwest Airlines, Nucor, Airbus,

and Lincoln Electric, effectively guarantee employment security, which breeds fierce loyalty among employees. Of course, significant expense cutting is needed to help maintain this no-layoff policy—travel and executive retreats are curtailed, executive bonuses are eliminated, and unpaid furloughs or four-day work weeks are imposed—but nobody loses their job. An added benefit to keeping these employees is that the company can use downturns to develop new product lines, explore new business niches, or expand into new markets.

A GREAT TIME FOR TRAINING

Today's business climate is also the right time for companies to invest in enhancing employees' skills through training and education. Boom times often preclude training, because employees are simply trying to keep up with escalating customer demand. Making sure employees stay abreast of information technology advances and other job enhancement tools is a strategy that builds crucial skill sets for the company's future.

In his new book, *Good to Great: Why Some Companies Make the Leap and Others Don't*, Jim Collins asserts that great companies always start with "who," not "what." Contrarian investing in people is a focus of the "who." It will payoff in your shareholder's future. ■

{ JUDY OLIAN is dean of Penn State's Smeal College of Business. }

MOVER, SHAKER, MORALE-BREAKER

BY DENISE A. ROISTACHER

Jane's goodbye party was in full swing at her firm's neighborhood pub. But Jane's co-workers were not toasting her because of her drive and extraordinary success on the job. While Jane was a high performer, her hyper-competitive personality and rude and insulting behavior had created a negative team environment. Her colleagues, essentially, were celebrating her departure because they were happy to see her go.

Managers are occasionally faced with the challenge of managing a top performer on the team who lacks awareness of basic civility, interpersonal skills, or team-building behaviors.

TAKING A HARD LINE

Managers must deal with this behavior before the rogue employee causes a ripple effect throughout the company. By supporting destructive behavior, a disconnect occurs between a company's core values and the actual behavior being encouraged. The message sent is that superior individual performance places an employee above rules and regulations.

Furthermore, colleagues will not want to work with, help, or support this kind of behavior. This means that certain projects could suffer, or that other valued workers will choose to leave. Jeanmarie Alessi, president of Alessi Consulting and Education, says "When I begin a leadership training program, I always say that people leave jobs for two reasons: they have bad bosses or they don't like the team in their work environment."



MANAGEMENT STRATEGIES AND TACTICS

Below are some tactical strategies managers can use with this type of employee. Don't be shy about letting other people on the team know you are working on the problem; for you to retain your credibility and authority, it is essential that other members of the team see that you are taking assertive action.

Be very clear where you stand on this behavior. The worst thing a manager can do is let abusive behavior among colleagues occur and not address it. Managers, however, often back off from speaking to the abusive star performer because it's uncomfortable, will likely be met by defensiveness and hostility, and may result in the person quitting right then and there. After all, as a top performer, this person may have gotten a free pass for

selfish behavior throughout his or her career, and your feedback may be highly unexpected.

Reward the kind of behavior you want to encourage. Are you rewarding bad behavior? Does your sales team get rewarded for closing deals, but not for sharing a lead with another sales person? If so, why should they work as a team when there isn't any reward or benefit in doing so? Simply put, you get the behavior you reward. In order to obtain team-oriented behavior, it helps to install performance management and bonus systems that reward it.

Give the person individually-oriented assignments. Another option is letting the person work completely on their own and away from others. Think twice before using this solution. You don't want to be perceived as rewarding this behavior by giving special privileges.

Assign a mentor or coach. If you are not getting anywhere as this person's manager, you could bring in an outside coach or mentor. The coach will do some assessment work, set up development goals, and work confidentially on a one-on-one basis with your problem employee. This option can be costly, but may be worth it if you really think you can't afford to lose the person. When a coaching relationship ends, organizational support such as rewards and feedback are important to sustain progress as the new skills are used. ■

DENISE A. ROISTACHER is a training and organization development specialist for the Federal Reserve Bank of New York. *The views expressed in this article do not necessarily reflect the views of the Bank.*

MANAGING DURING A CRISIS

BY JACQUELINE MROZ

After the terrorist attacks on September 11, the building management of a skyscraper in Chicago issued a memo: Everyone was to evacuate the building until they knew it was safe to work there. "Not my people," said the CEO of one company based in the building as he tore up the memo. A hero determined to lead his team through the crisis? Not quite. Shortly after vowing that his employees would stay, the CEO packed up his things and left the office, abandoning his staff.

That, says Greg Smith, a management consultant based in Conyers, Ga., is how *not* to lead your workers through a crisis.

EMPLOYEE SAFETY AND HEALTH ARE PARAMOUNT

In the weeks since the horrific events that stunned the nation, many companies have begun to reevaluate how they should respond during times of crisis. Some have been creating or updating disaster recovery plans, while others have been taking a closer look at what is necessary to lead employees through an emergency.

Smith, who learned about the Chicago incident from an employee who quit the company shortly afterward, says that when dealing with a crisis, leaders must first tackle their employees' fears and anxieties.

"Don't try to make them do anything, unless it's for their own safety and health," says Smith, president of a consulting



firm, Chart Your Course International. "You have to understand that, at that moment, nothing else matters except for their own safety, and the safety of their families."

Chris Melville, a program director for software company SCO Inc. at the time of the devastating 1989 California earthquake, understands that concept well.

Melville, who was in his company's Santa Cruz office when the 6.9 magnitude quake hit—with the epicenter

only miles away—says that after first making sure no one was injured, the company's leaders quickly put together a plan to take care of the personal needs of employees. He and other managers encouraged everyone to take time off to check on their families and to tend things at home. Next, they made sure that the damage to the building was quickly repaired.

"The most important thing is for people to work in an environment where they feel safe and protected," says Melville, now CEO and founder of Intersan, Inc., a software development company in Scotts Valley, Calif. "It was less important to take care of the product, even though everyone knew it would suffer."

ALLOW EMPLOYEES TO CHOOSE THEIR OWN ACTIONS

Giving employees some control over decisions in the wake of a crisis is one way companies can help employees deal with

the stress, says Steve Currall, associate professor of management and psychology at the Jones Graduate School of Management at Rice University in Houston, Texas.

"We all deal with stress in different ways, and management should acknowledge that. Some employees may want to go home, but a lot of people prefer to stay at work if it's not life threatening. They may deal with stress by keeping their nose to the grindstone—or they may not have anyone to go home to," explains Currall, adding that management should outline two or three choices to employees. "We shouldn't presume to tell people how to deal with these kinds of things."

Further, he says it's usually a mistake for companies to shut down an operation during an emergency unless there is a direct threat, because work is such an essential component of people's lives. "Their identities and their social networks are often tied up in the workplace. Why would you shut down that social setting where some of their closest friendships and best sources of support can be found? Don't throw them out to talk in the parking lot," says Currall.

For those who choose to stay, the company should quickly provide information to them. If televisions or radios aren't on, turn them on, Currall says. Have the chief executive send out a mass voicemail or e-mail to everyone on staff. Stockholders, too, need to be informed about any crisis within a company.

BE RESPONSIVE AND FACTUAL

Arlon Martin believes that open communication with employees during a crisis is essential. Martin was in charge of marketing for AT&T in Japan when the Aum Shin Rikyo religious cult released sarin gas in a Tokyo subway, killing 12 people and injuring many others.

Six of Martin's employees were on the subway at the time of the attack and had to be hospitalized. After making sure the injured workers were being treated, Martin and his colleagues quickly let the other employees know what had happened by issuing an internal press release, which included a straightforward statement about the incident.

"Employees don't want rumors, they want to know the facts," says Martin, who is now vice president of marketing for Agility Communications, a telecommunications startup in Santa Barbara, Calif.

He says it was important for the leadership of the company to talk about the incident to the staff and to acknowledge that the company had experienced some pain. Yet the business of the company kept on going.

"We recognized what had happened and made time for it," says Martin, adding that the company offered employees psychological support to deal with the incident. "But there was no thought of stopping. I think employees followed the example of leadership and were reassured."

"During a crisis, the most important thing is for people to work in an environment where they feel safe and protected."

—Chris Melville

COMMUNICATION IS CRUCIAL

Indeed, communication is key during a crisis. Give whatever news there is as early as possible, and tell it as honestly and as quickly as you can, says Deb Clifford, president of Inspired People, a leadership consulting company in Simsbury, Conn.

"Make it as real as you can get it, as close to face-to-face as you can. Then, you'll have the warmth, the tone, the body language, and the context," explains Clifford. She adds that holding meetings is a good idea, because leaders can greatly comfort employees during

these times by being visible.

"That's when you should walk around the company and ask people, 'Is your family safe? What can we do for you?' It's important to be accessible and open and to be there for your people," Clifford says.

Companies should also be sure to communicate that their disaster recovery plans are in place and, if the offices must be shut down, when they will be up and running again, says Clifford. All companies, including smaller and mid-sized businesses, should have such plans in place, she says.

It is also important for companies to educate mid-level managers and supervisors on how to deal with a crisis, says Smith, the management consultant from Georgia. They are the backbone of the organization, and they need to project a calm, confident, reassuring leadership style when there's trouble.

A POSITIVE FORCE

For Russ Henry, dealing with a major business crisis meant first taking stock of his level of commitment to his company. As a manager, he knew it would be even more important than usual to set an example for his workers.

Henry was director of product marketing and management for a Menlo Park, Calif., database company in 1997 when it was found that the company had missed its revenue projection by \$100 million. The Securities and Exchange Commission investigated the company, which had to restate its earnings back to 1994, and the CEO was forced to resign.

Still, while he stresses the importance of having a company address a crisis with its employees, Henry says there's a fine line between acknowledging a crisis and letting people express themselves.

"Sometimes we spent too much time talking about the crisis," recalls Henry, who is now senior vice president of marketing for Trigo Technologies in Brisbane, Calif. "We probably could have done more to help people move forward instead of dwelling on the crisis. At some point you have to be a positive force in a respectful way." ■

{ JACQUELINE MROZ is a freelance writer based in Montclair, N.J. }



financial services

roundtable

HEIDRICK & STRUGGLES ROUNDTABLE PARTICIPANTS

[from left] Brian M. Sullivan, Barry I. Bregman, Michael Franzino

As part of an ongoing series of interviews with the world's foremost authorities on leadership and human capital, Meredith Ashby and Stephen Miles, business analysts at Heidrick & Struggles, recently held a roundtable dialogue with a group of Heidrick & Struggles executive search consultants to discuss the current financial services environment. Participating in the roundtable were Brian M. Sullivan, vice chairman; Michael Franzino, senior managing partner of the firm's global financial services practice; and Barry I. Bregman, managing partner of the firm's Wall Street office.

Q: Can you give us an overview of the industry?

The global financial services marketplace is getting remarkably more complicated as it becomes more consolidated and more global. Major financial institutions now have legacies coming out of Frankfurt, the United Kingdom and Hong Kong, as well as New York and other money market centers. The asset management business in Europe has been undergoing a tremendous transformation, driven by Europe's realization of what the 401(k) business has done for wealth accumulation programs in the States and a growing acceptance of equity investments. Some European countries—principally Germany and Italy—are beginning to push away from the mindset that individual retirement plans are the responsibility of the state and shifting that responsibility back to the individuals. That change is driving the asset management business in Europe, as it has done historically in the United States. When you look at investment management in the U.S., there has been significant merger and acquisition activity which pushes companies to expand their product lines and to enter into new businesses. For example, those companies that had been primarily in the defined benefit business are now moving into the defined contribution business (i.e., pension funds versus 401(k) plans). Traditional investment managers are starting to make serious moves into hedge funds, previously a very closed business characterized by performance-based fees and aggressive money management.

In Asia-Pacific, the demand for physical infrastructure in China—airports, toll roads and related systems—is driving demand in the capital markets of the entire region. The somewhat fragile currencies and economies of the Asia-Pacific region in turn create huge opportunities in the foreign exchange and other types of money transaction businesses, although they tend to be on more of a boom-and-bust cycle. The region continues to be a stereotypical emerging market whose growth

is fueled by inbound investment. Countries such as Korea, for example, are becoming much more receptive to foreign investments, and therefore all the major U.S.-based firms are focused on learning how to do more business there.

Q: What about Latin America?

Latin America has many similarities to Asia-Pacific. The continent is a huge land area with some stable economies such as Mexico and Chile. On the other hand, some Latin American countries, such as Argentina, are fraught with political instability and the economic instability that results. In Brazil, there is a tremendous appetite to take companies public. The global private equity business is a



Michael Franzino

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Barry I. Bregman

fantastic dichotomy; in the States the private equity business has been challenged as valuations have come down over the last two years. Yet, in Europe and Latin America, there is a tremendous amount of fund-raising and investment activity. It really is a study in contrasts.

Q: As we approach 2002, what will be the bright spots in financial services in terms of specific hiring activity?

We continue to see a good flow of business in the entire asset management arena. One of the liveliest sectors is private wealth management, which is serviced by private banks and private client service groups within the brokerage houses, and by smaller high-net-worth boutiques and family offices, some of which have sprouted up in recent years. This activity is a function of the wealth accumulation that has occurred over the last decade. Some of that wealth has been given back in the market downturn, but there still is a strong demand for talented individuals in this particular area. Debt capital markets is another hot spot. Since the equity side is uncertain, client companies needing to restructure or build a particular component of their business are looking at their balance sheets and considering the viability of approaching the debt capital markets. Therefore, the distribution and origination side of the debt business has held up better than equity. There has been some strategic and selective hiring in these markets, particularly with firms that are taking a long-term view and are executing strategies to build high-potential new businesses or to enhance specific businesses. As a result, they are attempting to attract "A" players into a particular vertical group where they may currently have only "B" players. In other words, firms are up-tiering their talent banks.

Another area that has been very active is the hedge fund

business. This is because of the way hedge fund strategies are being developed and implemented. Using a portfolio of derivatives, these instruments have been able to perform well on a relative basis in the current volatile market. New hedge funds are being introduced and existing hedge funds are getting bigger. Both high-net-worth individuals and institutional investors are more receptive to allocating money in hedge funds, which are still climbing and have more room to grow. So, the market volatility has had a positive impact on recruiting talent for the hedge fund business. As individuals spin out of investment management firms to start up hedge funds, or as existing hedge fund capacities become tapped out, firms are forced to build out and add portfolio managers, marketing people, risk management and infrastructure people.

The other area where we are seeing strong activity is the payment processing area, on the front end and in the credit card business. Firms are deciding to invest in this area and are utilizing technology and more sophisticated quantitative techniques, rather than the good old "pure marketing" approach. Therefore, in terms of talent, they're looking for quantitative types to run their businesses—not marketers.

Q: Merrill Lynch has recently re-entered the private equity business. Do you see other large financial institutions making new investments in private equity businesses, or are there other market opportunities?

This trend may continue because of the future market potential for private equity investments in pre-public firms. Conversely, J.P. Morgan Chase recently closed its strategic investments operation, which is partly a reflection of the overall retrenchment in the equity market. With today's deflated valuations in the market, some of the larger financial services firms need to solidify parts of their business, and there are opportunities for direct investments and other investment strategies to take companies private. So, the private equity players should have some good pickings in the next couple of years. These conglomerates also need to look at their own portfolios and trim some of their equity holdings. Overall, it is important for us to look at talent in the private equity arena right now, and in particular, in markets such as Asia and Latin America, where funds are less developed. The hottest sectors for investments there are healthcare and biotech. If the equity market continues to be tough, we believe we'll see more opportunities in the mezzanine and leveraged buy-out markets.

Q: What is the current recruiting environment? What are the challenges and opportunities for financial services firms to land the best talent?

There are several themes pervading the marketplace in terms of recruiting. One is the level of anxiety, on both the supply side and the demand side. People are very uncertain about future employment and compensation. Last year, our

challenge was to convince senior-level executives to properly value second- and third-year guarantees. The prevailing view was that they had too much political and financial capital built up in their current jobs to walk away. Of course, many executives who were convinced they were on a fast track were eventually laid off or were otherwise affected. So today, there is very qualified talent in the market. This environment creates an excellent opportunity for firms to up-tier talent. On the consumer retail side of the business, in particular, we've seen a lot of firms capitalizing on this available talent to strengthen their benches and to develop new markets and businesses.

Regarding growth opportunities for financial services firms, there are two basic scenarios that hold a lot of potential for employment growth. One could be a major U.S. firm, for example, a global financial institution that is attempting to build a new piece of business. The other could be a foreign bank that needs to enter or obtain a better foothold in the U.S. market.

The confluence of these themes really makes this a very exciting market for firms that are trying to build out or consolidate their positions in certain sectors of financial services.

Q: Are financial services companies looking in other industries for specific skillsets?

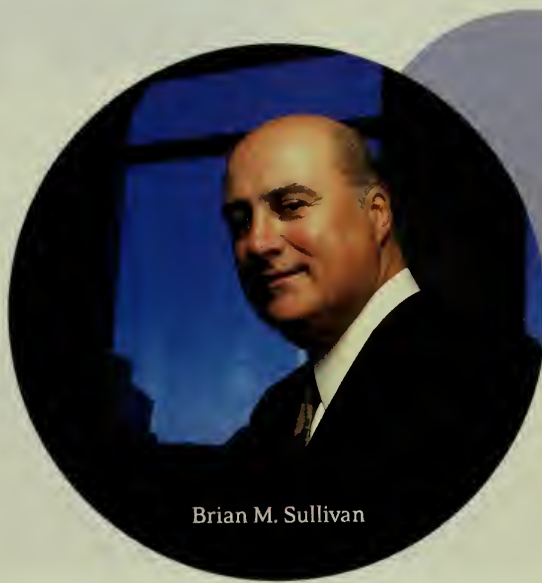
That's true in the functional areas, but in the pure markets, whether it's investment banking or investment management, they're staying within the experienced industry groups. There is, however, an evolving emphasis on implementing best practices and best "athletes" within the industry when core product or market knowledge is not required. We've recently recruited several executives for Bank of America who came from outside the financial services sector: Chuck Goslee, for example, who was head of quality initiatives for Kodak. Six months ago, Goldman Sachs made a very strategic move in recruiting Steven Kerr, formerly vice president of leadership development for GE.

Q: Do you see the financial services industry taking a new approach to human capital by putting more emphasis on developing and nurturing its next generation of leaders?

Historically, financial services has not been a breeding ground for prime senior management talent. It's really been more about, "What have you done for me lately?" and "How much revenue have you generated today?" It's a culture quite separate and distinct from that of a GE or a Procter & Gamble, which fosters long-term management development. Within financial services, there has been so much short-term wealth opportunity that it prevented the institutionalization of any true executive development programs. Where else could you be 28 years old and earn a couple of million bucks? The challenge for us is to distinguish why one person is where he or she is relative to another person. It's much easier to discern true leadership talent in Corporate America. In financial

services, much of it has to do with where you go to work, what business you work in, and what the market is like at that time. For example, this year, if you are in equities or are a technology portfolio manager, you may be sorely disappointed with your year-end bonus. Last year or the year before at the same desk you would have been a superstar.

What J.P. Morgan Chase & Co. is doing is a great example of how a large financial institution is focusing on developing leadership and management talent. They put Martha Gallo, former head of the firm's Six Sigma productivity and quality programs, in charge of LabMorgan, the unit responsible



Brian M. Sullivan

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for improving operating efficiencies and service quality within all of J.P. Morgan Chase's businesses. The firm also recruited Jack Welch to consult on institutionalizing leadership and management development.

Financial services organizations are at the point of recognizing that the most important resource they have is human capital. They have generally paid lip service to this notion in the past, but now we are beginning to see very real, tangible investments in people and executive development. By putting human resources people in very senior leadership levels and having them report to the CEO, these firms are demonstrating their commitment. The whole notion of not designating these managers as HR or personnel directors, but rather as human capital officers, sends a clear signal that the industry is stepping up to today's market and going after the best and brightest to achieve competitive advantage. ■

MORE HEIDRICK & STRUGGLES INTERVIEWS with the world's chief executives on the topics of leadership and human capital will be featured in an Oxford University Press book in the spring of 2002.

FUELING A {CREATIVE SPARK} IN THE SOUL OF THE CORPORATE MACHINE

BY WILLIAM SAND



A talented, sensitive, and smart designer had worked weeks developing a campaign to win the business of one of the world's largest banks. He arrived at a tense meeting of corporate leadership ready to present and explain his work. Minutes into the meeting, two of his three layouts were flippantly rejected. The third earned clipped approval and detailed instructions on how to fix the images. Walking out, he was shell-shocked, clearly feeling dehumanized.

His day in the sun turned out to be a few minutes of terror; and worse, he felt disrespected. As manager of his group, I explained that his experience simply reflected the nature of business at the epicenter of power. These were executives who got things done, who smelled the flowers only when forced to. That did not make them bad people, nor did it devalue

his contribution. In fact, he had succeeded by offering a workable design.

STRADDLING TWO WORLDS

This story illustrates the defining tension of a creative group operating within a large corporate environment. The creative group uses imagination and inventiveness to produce new or striking results. Companies acquire these people for the spark they provide. Without them, without their willingness to go out on a limb and try something new or risky, business would be stuck in time. No FedEx. No fax. No Happy Meal. No Hula Hoop. No PC. No Internet. No Post-it.

Yet, the corporation typically places efficiency and effectiveness first. Company managements want good, serviceable (and often conservative)

ideas fast, putting a premium on productivity. This mindset can quickly cut into the latitude given to areas that might be considered frills or even as "cost centers." The result is an inherent tension between the creative niche and the corporate machine.

In a decade of building a corporate communications group of 100 writers and designers at a Big 5 accounting and consulting firm, I learned that success managing this relationship depends on two things. First, understanding and balancing the motivations, perspectives, strengths and weaknesses of all constituents—the creative group, the company, and yourself, as the creative director or manager. Second, knitting things together so the whole exceeds the sum of its parts.

The goal is to build an environment

where creative professionals gain the satisfaction they thrive on and the corporation obtains high-quality results. But the alchemy that achieves this is elusive. In fact, getting it right requires intelligence, caring, cunning, flexibility and, likely, long hours.

FIRST AND LAST, HIRE WITH CARE

If you have a picture of what a creative professional looks like, check your preconceptions at the door. I am always amazed at the diversity of backgrounds and temperaments that make stellar performers. Creative professionals are often seen as a bit different from the "norm"—more sensitive, independent, rebellious, and self-absorbed. Whether writers, graphic designers, architects, scientists, or software developers, these people are motivated primarily by pride in their work and a sense of fun. Standard career motivations—money, power, and stature—are typically secondary.

The first and most important step in building a strong creative function is hiring with discernment. Don't delegate that task. Do spend time on the process, especially interviewing. Look for both motivation and skill. Use your instincts as well as logic in hiring. Avoid emotional "soft spots"—appealing eccentrics, dreamy flakes—whatever yours might be.

On the motivation side, try to assess what makes the person tick. Are they impelled from deep within to do what they are doing? If so, that's a great plus. Or do they want a cushy, socially acceptable job that sounds good to the folks back home? The kiss of death in a corporate creative department is hiring nominally qualified, politically acceptable, but untalented people. They don't cause trouble, but they don't deliver results either. Ultimately, they rob the creative function of value.

Hiring people primarily motivated by pride in their work takes advantage of powerful leverage, too: That is, the more a creative professional believes he or she is working to achieve inner goals, the harder they will push themselves toward excellence and the less you will have to manage anyone, ever. Their own work ethic will do the job.

While it's an art to find people with

strong inner motivation, time and concentration will point the way. Discerning skills beforehand is another matter. A bit can be gleaned from conversation and portfolios. Much more can be determined by tryouts and tests (which in some cases must be certified to comply with federal hiring guidelines). But still, beyond broad gauges, it's hard to predict the quality of results before a person enters the office.

Don't be stingy with money for compensation and training (within the confines of your corporate limits, of

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course). Money used wisely builds individual and group self-esteem. That's healthy. The investment will be returned many times over in good work and dedication.

STRUCTURE A FAIR ENVIRONMENT

Next, build an environment that is fair, honest, professional, fun, and devoid of unnecessary bureaucracy. Creative professionals will work willingly and unselfishly if given these building blocks. If, however, they are in inequitable or dehumanized surroundings, their natural skepticism and independence will kick in and they'll make life miserable for themselves, the company, and you.

As their manager, it is up to you to instill the ethos that results are No. 1, but integrity follows closely behind. Insist that no one will get ahead by tripping the next guy. Make it clear that

you are an impartial judge who will make logical decisions for the good of the group and the company first. Live by that and set an example in your work and behavior.

While antisocial behavior among "creatives" is sometimes seen as charming, inherent, or valuable in terms of generating ideas, a line has to be drawn. Successful working groups go in one direction—toward results—and achieve a sense of community in doing so. They cannot tolerate behavior that hurts the group, such as patterns of egoistic bullying or slacking off at others' expense. This is not to advocate narrowness. Tolerance eventually manufactures energy and ideas; it's a life force.

Creative environments function best by avoiding administrative burdens and ballyhoo as much as possible. Put another way, do your work, do what the corporation and good business mandate, but don't celebrate bureaucracy. No one appreciates it.

BUILD BRIDGES TO THE BUSINESS

Both the creative group and the company must feel you are advancing their agenda. As such, you owe the group all the coaching, business information, and direction you can provide to best target their efforts. You also must serve as a go-between, explaining new corporate policies as they emerge.

On the other side, the corporation holds you accountable for quality, results, efficiency, and effectiveness. You need to speak to company leaders in a language they understand, and even cultivate an image as one of them. It's a fine line—you must respect your own creative goals; on the other, the demands of the business.

In the end, you are a translator, a protector, a creative professional, and an arm of management. It can be hard. But hew to the rules of impartiality, good business sense and mutual self interest. A bit of humor and self-effacement also helps to buffer things along the way. ■

WILLIAM SAND, formerly national director of business development strategy and proposal communication at KPMG, spent 10 years building and managing a group of 100 writers and designers in seven cities.

A HERCULEAN TASK FOR AN

OLYMPIC LEADER

For almost two years, Mitt Romney has worked for no salary at a job most people would run away from.



BY CHRIS MITCHELL

In February 1999, a widely publicized corruption scandal had just created an opening at the head of the organizing committee for the 2002 Winter Olympic games in Salt Lake City. The right candidate had to soothe jittery sponsors, reinvigorate a dispirited workforce, endure the bright light of international media scrutiny, and regain the confidence of a leery public. Oh, and yes: There was also the matter of ensuring that 3,500 athletes, hundreds of thousands of fans, and 9,000 broadcast and print media people had arenas to compete in, beds to sleep in, and a transportation system to move about in.

Mitt Romney, the founder of Bain Capital, a Massachusetts venture capital firm with \$13 billion in assets under management, had faced uphill battles before: In 1994, he ran for the Massachusetts U.S. Senate seat held by Ted Kennedy, and put a scare in the Democratic stalwart.

But nothing prepared Romney for his first weeks on the job at the Salt Lake Olympic Organizing Committee (SLOOC). Freelance writer Chris Mitchell, a senior editor of *The Week Magazine*, spoke with Romney about the leadership challenges of managing the biggest sports event on earth.

Q: Every few months, if not every few days, the challenges facing the SLOOC seem to change dramatically. Is this the job you expected it to be when you moved to Utah?

Anyone who takes the helm of any large organization will find that the sailing ends up being quite different than what was anticipated. That's the nature of sailing on the high seas: Storms and calms are thrown at you that you never would have expected. That said, the Olympics have been even more variable than any business I've been involved with.

When I started, I presumed that my job was to overcome the scandal. That entailed rebuilding the public confidence in the Salt Lake games and reigniting the spirit of the Organizing Committee team. But I soon found a \$379 million hole we had to dig out of. To do that, we had to cut our cost budget by \$200 million and raise almost as much from sponsors and donors.

Q: How were you able to find the \$200 million in cost savings?

The \$200 million was found in myriad small costs. When an organization has to make cuts, the worst thing you can do is to make everyone bleed equally. Instead, we identified our top priority as providing superb sport facilities, and we didn't take one dollar out of that category. We took the savings out of nice-to-have appendages like decorations and celebrations.

Q: And where did you turn for the additional funding?

We went largely to sponsors and to ticket sales. With tickets, we used prices for the Nagano, Japan, games as a benchmark, increased the prices for inflation, and then added about 15%. We broke all Olympic records in the amount of money raised from domestic sponsors. The Atlanta games raised \$481 million. We have so far raised \$859 million.

Q: To win new sponsors, you had to confront the scandal. What did you do to win back public confidence?

When the public is rightly critical and suspicious of an organization, the first steps are to open the organization to public scrutiny and put in place an ethical policy for all employees.

So one, we changed the management team. Two, we opened all records and documents that could possibly be opened. Three, we opened our board of directors meetings to the public. Four, we laid out very clearly the financials of the organization, and five, each employee was required to sign a written code of ethical conduct.

If you open your organization to scrutiny and demonstrate a commitment

to ethical conduct, the public may not be convinced you're competent, but at least they'll believe you're ethical.

We also had to address a morale problem. The entire Salt Lake community was feeling like they'd been kicked in the stomach, the 300-person team at the SLOOC was highly dispirited, and both groups needed to be reignited.

Q: How did you accomplish that?

Well, I laid out my vision—guiding principles of how we would work together—and then asked our human resources director to establish a series of discussion groups to determine what the employees thought our guiding principles should be. We published these within a few weeks of my arrival. There

Someone once said to me this must be like organizing a Super Bowl a day. Frankly, I had to laugh at that.

—Mitt Romney



are 20 guiding principles, grouped in five main categories: teamwork, passion and pride, communication, integrity, and fun and celebration.

Q: Can you share a couple of examples?

Sure. Under passion and pride, one principal is "Realize your impact on history while at the Olympics." Under communication: "Be loyal to those not present."

My favorite principle is "Encourage laughter at all meetings." To give you an example of how we do that, we recently issued to the media a list of the 10 dumbest things we had done in the last year, and we issued an Olympic pin shaped like a baseball mitt that says, "Mitt happens."

Q: Are the dumb things on your top-10

list humorous?

They're only humorous in retrospect. Things like not having enough telephone operators on the first day of ticket sales—people were lined up for hours. Like any organization, we make mistakes, but we try to recognize them and correct them instead of looking for someone to blame.

Q: Describe, if you can, the scope of the work that all has to come together for those 17 days in February.

Well, in some respects, it's a mountain of details, all of which have to be executed without flaw if we're going to have Games that showcase the athlete and keep the SLOOC out of the picture. And to give you some sense of scale, someone once said to me this must be like organizing a Super Bowl a day. Frankly, I had to laugh at that. Think about organizing a Super Bowl: The arena is built. There are two teams, and there's one broadcaster. The parking facilities are all complete, the on-ramps and off-ramps are all complete, and the ushers know where to seat everybody.

Now contrast that with one of our smaller Olympic events. Take biathlon and cross country, for example. For those two events, we had to build a venue, which included 24 kilometers of trails. We have to prepare broadcast booth facilities for 70 different broadcasters from around the world. We have to have 52 locker rooms brought in, including sanitation, communications and so forth. We have to build all of the parking facilities for the spectators, and provide a transit system that will bring those spectators from the parking lots to the venues.

It really is a remarkable challenge. We're borrowing, for instance, 800 transit buses from cities across America to help move our spectators. You think: That sounds like a real challenge. Well, imagine how you get the buses here to Utah, and then you have to find someone to drive them during the Games. We have to borrow drivers from across the country.

And then who's going to wash and maintain the buses, and how about

fueling them? We have to build a fuel depot; we have to build three new bus maintenance facilities.

Some of the things behind the scenes, the magnitude is just extraordinary. Our information technology budget alone is over \$300 million.

Q: How big will your workforce be?

We have over 1,000 personnel now. We will go up to roughly 1,500 employees, and then our volunteer team is 22,000. And as you can imagine, the volunteer team is already in rehearsal now and in training for their work.

Q: And everything has to come together during one 17-day period. What benchmarks do you use to ensure the whole team is moving in the right direction and will be ready for the first day of the Games?

Well, I'm fortunate that my team has extraordinary skill and experience in preparing for an event that bursts into existence for 17 days and then disappears. My chief operating officer, a guy named Frazier Bullock, is world-class, and the other members of the team have extensive experience in organizing events and major projects, but it taxes the best of them.

We go from a complete standstill to having to move 100,000 people in transit systems that are currently not even operating. And so overnight, everything is expected to work.

The truth is, it can't possibly work overnight, and therefore a key to making the experience successful is having sufficient flexibility to correct the mistakes as quickly as possible. No one in the Olympic movement should ever say their transportation system, or their technology, is going to work perfectly from the start. We know our transportation system will have snafus, that our information technology will have glitches, that there will be difficulties moving people into venues quickly enough. We'll have weather problems, too. But we have to learn how to respond to those problems. Therefore, a great part of what we're doing now is not just planning, but carrying out contingency exercises.

They began with what we call tabletop rehearsals, where we bring all the people who are running a venue together and then present them with unusual circumstances and ask how they would respond. We've now started field rehearsals, where we actually go into a venue and create mock problems, from an avalanche, to people coming in with duplicate tickets, to electricity going off, to our telecommunication system shutting down. All of these contingencies are thrown at a venue team and they work their way through them. In late October, we performed our first all-venue technical rehearsal, where the technology from all our venues was connected to our home technology center. We simulated sport events occurring all at the same time and the results being collected centrally and being disseminated to

*This will be the most
secure event in the world.*

—Mitt Romney



broadcasters and media. We found all sorts of problems that we then had to go back and correct. And we'll do that several times.

Because the Olympics is an event with an absolutely certain start date and an absolutely fixed budget, there is no room for delay or overruns. Everything has to be worked out in great detail, and everything has to be tested through contingency.

Q: You've spoken before about the lessons you learned from previous host cities. What lessons in particular should future host cities take from the Salt Lake experience?

Well, the best way to learn is to watch our mistakes, and it's hard for me to predict what mistakes we'll make the rest of the way. We've learned from the mistakes of our predecessors, and their leaders have been generous in giving us their advice, from Peter Ueberroth in

L.A. to Billy Payne and A.D. Frazier Jr. in Atlanta to Michael Knight in Sydney to Gerhard Heiberg in Lillehammer.

These people work with us to describe the things they were surprised by. And we have attempted to correct for their mistakes, which of course prepares the way for us to find our own mistakes. And it will be those things we pass on to those who follow us.

Q: How confident can you be that the fans, the athletes, and the media will be safe at the Salt Lake games?

Well, this will be the most secure event in the world. No other event comes close to having \$300 million of security resources, from aircraft and airspace interdiction, to agents on the ground, to monitoring systems and devices. Every single source of potential threat is being evaluated and that risk will be minimized. The security operation is being funded, overwhelmingly, by the federal government, the Secret Service, the FBI, and other federal agencies to assure that athletes and spectators and the community are safe.

Q: Finally, a question on what's next for you: You've said you don't intend to return to private business when the Games end but want to take on a new challenge in public service. How did your Olympic experience affect that decision?

The reason I took this job is I care very deeply about the Olympics, and about this community, and about the nation. And I have enjoyed immensely the association with the Olympians. You know, making money is a necessity, and yet, serving a greater purpose is a thrill I would hope I could continue to pursue.

Time will tell what opportunities arise. I have run for political office; I would do that again if the right opportunity is available. I have served on boards of not-for-profits and would be happy to devote more time there. If you're in a position to be able to give your time, there's a wide range of options open to you. ■

{ CHRIS MITCHELL is a senior editor of *The Week Magazine*. }

THE NEW WORLD

DISORDER

BY DAVID WYSS

In early September, the economy was already on thin ice. The manufacturing segment of our economy was in a year-long recession. Consumer confidence was down sharply in early September, according to the University of Michigan's Consumer Sentiment Survey. But at least it appeared that the recession would be limited to inventories and capital goods, leaving the service sector of the economy relatively untouched.

America's households were doing the heavy lifting of keeping the economy moving through consistent consumer spending and home purchases, despite the sharp declines in inventories and business equipment spending.

Then, of course, came the heinous September 11 terrorist attacks on New York City and Washington, D.C. The attack's repercussions turned a contained, limited recession into a widespread, sustained downturn.

Retail sales in September certainly suggest that spending dropped even more than the confidence data suggested. The 2.4% decline was concentrated in areas that one would expect to suffer most, especially car sales and clothing (deferrable purchases) and restaurants (entertainment). Consumers were—and still are—scared, and they are more interested in watching television than having a good time. The mood is very somber, and many feel guilty about being too happy.

This attitude should wear off in time, but only when there is less to be scared of. Fears about health and safety are being joined by fears of layoffs. In this environment, the saving rate will rise and consumer spending will drop. The question is: By how much and for how long?

THE FIRST SCENARIO: A RELATIVELY MILD RECESSION

The first scenario is a mild recession ending in early spring, which is what I expect. Since the onset of the downturn



is likely to be backdated to this past March or April, this would make the recession one of near-average length, about a year. As for how much damage will be done to the economy, my view is that this recession will be about half the size of the 1990-91 recession.

With the nation at war and consumer fear at fever pitch levels, why do I think the recession will be relatively mild? Primarily because of the stimulus to the economy already in the pipeline. Interest rates have plunged since the beginning of the year. The Federal Reserve lowered rates for the tenth time this year at its November meeting, bringing short-term interest rates to their lowest level since 1958. The

federal funds rate is already down four percentage points, from 6.5% at the beginning of the year to 2.5%.

We can expect even more stimulus for the economy. Congress will probably pass even more in tax cuts and spending increases than the Bush administration has asked for. The result will be deficits, which are appropriate when the economy is in recession. Ideally, surpluses will reappear as the economy gets back to full employment.

THE SHAPE OF THE RECOVERY

The recovery is expected to bottom in the first quarter of 2002, although the unemployment rate will not peak (at 6.5%) until that summer. The huge federal and monetary stimuli should create strong growth in late 2002. After that, however, expect the economy to slow again, as federal spending dries up and the Federal Reserve holds interest rates steady.

A SECOND SCENARIO

The second scenario is a longer and deeper recession propelled by world events. Further terrorist attacks, more flare-ups in the Middle East, or a widening of the war on terrorism could set back the upturn. Disruption of oil supplies could also add oil price inflation to our list of woes.

The key to the recovery? As usual, the American consumer. How quickly consumers regain the confidence to spend and invest will determine if the recession is relative brief and shallow in scope or whether we're in for a much rougher ride. ■

{ DAVID WYSS is chief economist for Standard & Poor's. }

NURTURING TALENT AT BANK

OF AMERICA

With more than \$640 billion in assets, Bank of America is one of the world's largest financial institutions. After completing a series of acquisitions, Bank of America has turned its focus to internal growth, building its network globally and further complementing its services offering. The following is part of an interview conducted by Heidrick & Struggles business analysts Meredith Ashby and Stephen Miles, along with senior partner and relationship manager, Jory Marino, with Bank of America's CEO Kenneth D. Lewis and personnel executive, Steele Alphin.

Q:Regarding Bank of America's evolution from a company that grew through acquisitions to a company growing via internal growth, are there different skills required of the leadership in this new environment?

LEWIS: The previous model valued charisma. Being a charismatic leader—having excellent communication and negotiation skills—is still immensely important, but now you also have to be a good manager by knowing the business, paying attention to detail, and finding beauty and excitement in getting it right for customers and clients. You also have to find beauty and excitement in doing it better than before, day in and day out.

The big excitement can't just be the episodic event of an acquisition, merger or alliance of some sort. It has to be these day-in and day-out, grind-it-out things that probably call for a different personality, a different person. Consider also that in the former model, a relatively small group of people had disproportionate influence on the success of the company. First, there was the negotiating person or team, and then there was the execution of the event and, finally, the operational conversion.

Many times, the way you succeeded was to get the deal first, and then do draconian things to cut enough expenses to make the numbers work. You rarely talked about revenue and, ironically, you would even build into your model the number of lost customers you found acceptable, because you knew that during the operational conversion that was inevitable. Now, growing organically, you have a situation where there's not that

disproportionate contribution by a small group, which means we all have to contribute on a more equitable scale. And all the soft things that leaders have to focus on become very important—those areas such as professional and leadership development, work and family and quality of life issues, whatever it is that gives your people a reason to be excited about waking up and going to work every day.

Q:While you're focusing on business transformation, new leadership models and recruiting, you run the risk of losing focus on retaining your existing talent. How can you balance the integration of new skills and talent, while at the same time cultivate the skills of your employees?

ALPHIN: We look at both a person's current performance and their potential to take on more responsibility. As long as the performance is strong, they'll have a long and fruitful career here. In fact, what we're finding is that our existing talent is energized by new teammates. Conversely, our new talent is impressed and energized by our existing talent, our culture, and our passion for winning. While we'll never forget what got us here in the first place, top grading is now a way of life here. Everyone simply has to perform better. We value our meritocracy, and it's part of our commitment to ourselves and to the market that we're going to do certain things.

Q:You've gone outside the banking industry—to FedEx, GE and AlliedSignal, for example—for some key people, bringing in world-



KENNETH D. LEWIS

class talent as opposed to just looking in the financial services industry. Why go outside your traditional industry for talent?

LEWIS: We want to be one of the world's great companies, not just one of the best companies in the financial services industry. Therefore, inherent in that goal, we believe there are standards and benchmarks that are higher in certain industries and in certain areas than in the financial services industry. We also realized that we did not have enough talent internally, particularly people with engineering and Six Sigma backgrounds. We clearly had embraced the importance of process and of breakthrough improvement, but we didn't have all the expertise or experience to get us where we needed to be. A lot of that kind of talent was found outside the financial services industry. Once on board, those new teammates with new skills made us more attractive to other top talent. You end up with a group of people who push others out of their comfort zones and out of the inertia of doing things the old way. This is the catalyst for change.

ALPHIN: Let me give you the bottom line: If you are an introspective leader, and you truly understand what you're trying to accomplish in the game you're a player in, it gets pretty simple. You buy skills that you don't have. You recruit people who give you a competitive advantage because of the skills they have, even if those people are not in

your industry. When we inventoried our skill base through our formal talent management process, we saw there were gaping holes where we needed different types of people, where we had not moved as we should have.

Q:The risk associated with any change is the threat to your culture. How do you inject new talent into your organization and yet sustain the part of your culture that people have always been able to recognize and thrive in?

LEWIS: It's salting the organization with new talent that strengthens your culture. Bringing in new perspectives augments the world-class talent base that has been with you for some time.

Q:Building your talent pool is an ongoing process. However, once your top talent is in place, how do you take it to the next level in terms of education, leadership training, and development?

LEWIS: We have several ways we develop talent. First and foremost, we realize that an underlying part of leadership development is ongoing communication and dialogue among senior managers. We meet on a quarterly basis as a group to identify the specific need at the various levels, to talk about success stories and failures, and to talk about the process for change where change is necessary.

My senior managers have my support to network and meet people outside of their areas and functions, so that they can continually be in a recruitment and development mode. We have leadership sessions all over the country. We also spend a lot of time on talent planning to make sure we identify the high potential executives, manage their assignments, ensure they're getting candid feedback and coaching, and get them involved in something developmental. For example, getting a cross-functional team together and then attacking a real business issue. This exposure to the top management team energizes the whole group.

Q:What do you think the financial



STEELE ALPHIN

services landscape will look like in years ahead? What types of skills and qualities will the leaders of tomorrow's financial services companies need to have?

LEWIS: I think you'll have fewer of everything: Fewer insurance companies, fewer investment banks, fewer banks, fewer asset management companies, fewer qualified people. The banks will likely survive because of the sheer size of their equity bases and the power of their earnings strength. As this begins to happen, a global perspective becomes more and more important, as does the idea that you cannot be limited to any one country or any one region within the world.

Managerial skills will become even more important because you've got to be paying attention in a lot of different ways, and controlling risk is critical as you become much more multi-faceted. Endurance will be important as you enter new and emerging markets. But other things that make a successful company will never change: Creating a caring environment, making your organization a place people want to come to every day, and instilling a sense of pride in your associates. ■

MORE HEIDRICK & STRUGGLES INTERVIEWS
with the world's chief executives on the topics of leadership and human capital will be featured in an Oxford University Press book in the spring of 2002.

building leadership innovation at



PepsiCo

Earlier this year, Steve Reinemund succeeded Roger Enrico as CEO of PepsiCo. Whether it was conceiving of and building the world's largest pizza delivery system at Pizza Hut or leading Frito-Lay to record profits, Reinemund, now in his 17th year at PepsiCo, has never been content to sit and wait for opportunities to come his way. Under Reinemund, the beverage and snack food titan spent roughly \$15 billion acquiring Quaker Oats and SoBe drinks, and continues to introduce successful and innovative products to the market. Heidrick & Struggles business analysts Meredith Ashby and Stephen Miles recently went to the company's Purchase, N.Y., headquarters to talk with Reinemund and Lucien Alziari, PepsiCo's staffing and executive development vice president, to get their perspectives on today's leadership issues.

One-on-One with Steve Reinemund

Q: What is your approach to leadership?

A leader's job is to define an overall direction and motivate others to get there. Most companies have relatively few people doing a lot of the important work, but in an organization such as ours, a lot of people are involved in everything we do. PepsiCo's heritage is that we've only had four CEOs in 40-some-odd years, but each of our businesses is autonomous, with many leaders running each one. My leadership style has changed over time, because what needs to be done continually changes. When I was running a division, my role was very different from running a corporation of our size and diversity; so, along the way, I had to re-evaluate what leadership characteristics were needed for the job at hand. Few people recognize that when their job changes, their style should change as well. As a division president, for instance, you can be more direct and tactical; as a CEO, your role is more like that of a coach and a coordinator of other leaders.



Q: What will be your contribution to PepsiCo's heritage?

We've evolved over time as a place that develops people. My predecessor, Roger Enrico, spent a lot of time on executive development programs. By the time I finish here, I hope to have added some real value in that area as well, but one place in particular I believe deserves more emphasis is workforce diversity.

If we fail to arrive at our goals in the next few years regarding diversity and the ethnic and cultural diversity of the organization, we will not continue to be a world-class consumer products company. If we achieve our goals, we will by virtue of our ability to replicate within our organization the demographics of our consumers. Several years ago, we were not unlike a lot of other companies in that our senior executive team was not very diverse. In effect, we were recruiting from a pool of only 34% of the [U.S.] population. While we did a pretty good job of attracting qualified people, we were limiting ourselves to a small portion of the available talent. We also had perspectives that allowed us to be successful

only in certain marketplaces. For example, Frito-Lay had roughly 60% market share in the U.S. as a whole, but in urban markets, it was down in the thirties. When you get 60% overall market share, there are not a lot of avenues for incremental growth on a market-wide basis, so you try to figure out where else you can target. Urban markets are growing two to three times faster than suburban markets, and we basically weren't competing there because we didn't understand that consumer base. We were missing a huge opportunity.

With a diverse senior management, we also have the ability to attract other highly qualified people to come into the company. Not only is diversity the right thing socially, it can be quantified as good business. We have been recognized as a top place to work for minorities and women, but we still have further to go. To follow Roger's passion about developing people, we are augmenting our executive development programs with a diversity component. For example, we have developed a one-week leadership training course with UCLA where external and internal senior executives—myself included—teach and mentor minority executives.

Q: Do you have a formal process in place for assessing the talent of an acquired company, and if so, who makes those decisions and reviews?

We all play a part in this, but I look to our human resources staff to take the lead. It is part of our acquisition intelligence-gathering strategy to assess the talent to some degree before we make the deal, as we negotiate the deal, and then certainly after the deal. We ask our search partners, such as Heidrick & Struggles, to give us a read on the talent in the target organizations, to identify the gaps and to help us evaluate and gather intelligence. Once we are able to actually meet the executives, we all spend a lot of time one-on-one to get to know their issues and aspirations—professional, personal, and financial—in an attempt to find the best possible fit for us all.

One-on-One with Lucien Alziari



PHOTO BY ALAN MACWEEENY

Q: In terms of PepsiCo's next generation of leaders, what will the performance benchmarks be?

We focus on a number of areas in developing well-rounded and high-impact executives. The first requirement is results—that's what gets you in the game here. Then we look for the right mix of leadership capability, functional excellence, and business breadth, or "knowing the business cold" as we say here at PepsiCo. Finally we look at the critical experiences an executive has had over the course of many years, both to see how well they have adapted to different challenges and to ensure that each new experience is additive, not a duplication of something they've already done. In return, we need to offer new opportunities for growth, which provide a runway to enhance these talents. We adjust these factors over time to get the optimal balance, but we have found that this is the combination that creates impactful, successful leaders.



Our innovation pipeline needs to be full for many years to come; that's a necessity with businesses as large and as visible as ours.

—Lucien Alziari



Q: PepsiCo has developed a culture that is built to change and built to innovate, something very important for competitive advantage today. How do you get people to thrive on change and innovation so that they view problems as opportunities rather than roadblocks?

The categories we compete in demand innovation. In the soft drink business, as a number two competitor in the market, you can't win by copying the other guy or by outspending him. You win by outflanking the competition with ideas that they would never think of (or they would shy away from if they did). Our innovation pipeline needs to be full for many years to come; that's a necessity with businesses as large and as visible as ours.

For example, if our Frito-Lay North America business is about \$9 billion, and we figure a substantial fraction of its growth will need to come from new ideas, then our pipeline needs to have at least \$3 billion worth of innovative products headed for the market. The numbers and opportunities are huge. Innovation is critical in every business we're in, either to keep an edge on Coke or, as with Frito-Lay, to keep on growing the category. It's the same in the Tropicana business, where we're redefining the not-from-concentrate juice market. If you look into why Gatorade succeeded, you'll discover that it was because of enormous innovation over the years. Innovation is a core part of our culture; our people expect it and feel good about it, and it lies at the heart of their approach to solving problems. ■

"PepsiCo is an exemplary organization, not just because of its superior products in the marketplace, but also because of its human capital value chain, which views people as its greatest asset. This approach—valuing talent, constantly building and developing its next generations of leaders, and maintaining an innovative culture that reinforces and rewards this behavior—has probably given PepsiCo more stead in the marketplace than all its brands put together."

—Dale E. Jones
Managing Partner
Southeast
Heidrick & Struggles
International, Inc.



MORE HEIDRICK & STRUGGLES INTERVIEWS with the world's chief executives on the topics of leadership and human capital will be featured in an Oxford University Press book in the spring of 2002.

The U.S. is among the most innovative, efficient and successful economies in the world, and much of this success derives from the considerable decision-making freedom afforded U.S. businesses. It is also clear, however, that from time to time many Americans become frustrated by what they perceive as a gap between what Corporate America does and what Corporate America *should do*.

Recent examples include the pharmaceutical firms' hesitation to provide HIV-fighting drugs to afflicted countries that lack the resources to pay market prices, as well as criticism by many that it was un-American to lay off workers in the aftermath of



agement to determine the set of actions that best reflect shareholder sentiment. In addition, the largest shareholders tend to be institutional investors such as mutual funds and pensions that have a fiduciary responsibility to maximize the returns of their clients.

It is important to remember that even if shareholders agreed on the desirability of socially conscious actions, standard economics dictates that firms will not go as far as society may wish. The reason is that the costs of undertaking the socially responsible action are borne primarily by the company but the benefits are reaped by society as a whole.

The bottom line is that businesses cannot always be relied upon to make

THE ECONOMICS OF CORPORATE SOCIAL RESPONSIBILITY

BY WAYNE R. GUAY

the horrific September 11 terrorist attacks. To some, these are instances where Corporate America shirks its social responsibility.

So, why would firms choose not to be socially responsible? Are the executives reading this magazine bad people? Do they derive personal satisfaction from being socially irresponsible? Of course not. Executives have a fiduciary responsibility to make decisions that are in the best interests of the owners of the firm—the shareholders. Before they can do that, they must determine when it is in the interests of the shareholders to be socially responsible.

DOING WELL BY DOING GOOD

Sometimes, these decisions are very easy, as is the case when socially responsible actions are just good business decisions. For example, charitable activities, such as sponsoring a charity fund-raising event or providing goods and services to underprivileged groups, have publicity

value that may outweigh the costs. Managers can feel good about taking the socially responsible action and at the same time maximizing shareholder value.

BALANCING SOCIAL RESPONSIBILITY WITH FIDUCIARY RESPONSIBILITY

In other cases, however, the costs of the socially responsible action exceed the benefits. For example, the costs of investing in pollution-reducing equipment may be more expensive than illegally polluting a river and living with the probability of being caught and fined.

Shareholders, people like you and me (more than 50% of U.S. households own stock), are typically willing to sacrifice some profit in the best interests of society. The problem for corporate managers is that not all shareholders agree on the appropriate tradeoff between profits and social responsibility.

It is extremely difficult for man-

decisions that maximize social welfare. To combat this, individuals often engage in a variety of activities that impose costs on socially irresponsible firms. Examples include boycotts on products, lobbying for government intervention, and investing in socially responsible mutual funds or companies. This latter action is a relatively new phenomenon. Presumably, the objective of avoiding stocks of socially irresponsible firms is to impose costs by limiting the access of these firms to capital. Since U.S. firms have so many financing options, this strategy is unlikely to lead to serious capital constraints, unless a very large fraction of the population participates. An alternative—and potentially more effective investing strategy—is to invest in socially responsible firms, possibly through mutual funds, and then use share own-

{ WAYNE R. GUAY is an assistant professor of accounting at the Wharton School, University of Pennsylvania. }

FINDING THE EXECUTIVE POSITION: FLEXIBILITY IS KEY

BY MICHELE PULLIA TURK

As we approach 2002, job seekers face the toughest job market of the past decade. Whether directly related or not, the terrorist attacks of September 11 marked the turning point from a lukewarm job market into a freezing cold one, with massive corporate layoffs in the months afterward. There were nearly 250,000 job cuts in September alone, according to Challenger, Gray & Christmas, the Chicago outplacement firm.

Executive level positions are particularly scarce. An online subscription job service targeted at executives, www.Netshare.com, has seen a 20% drop in job listings compared to a year ago, despite an aggressive marketing campaign. "There's definitely a significant slowdown in the very senior level across the board," says Dave Theobald, chairman and founder of Netshare. "Companies just don't want to spend the money—they've put these jobs on hold or canceled them."

Fortunately, there are always a handful of industries that flourish, or at least hire strategically, during a recession. "There are some industries that are still quite in demand," says John Challenger, CEO of Challenger, Gray & Christmas. "There are also areas of strength in this economy."



Landing a plum job in this economy will require the flexibility to look in these still-growing sectors, even if you think it's a stretch from what you have done in the past. Your skills may be more portable than you think. "Most of us have jobs that are quite transferable from industry to industry," says Challenger. "You don't get defined like you used to, as a railroad person or an insurance person." In fact, according to Challenger, 40% of people change industries for a new job, although most

stay within their field or area of concentration.

Organizational psychologist and career management consultant Andrea Alfus Rothman, president of the Wenroth Group in New York, recommends looking for jobs at little-known mid-size companies who rely on new recruits to sustain their competitive edge. "There's a scarcity of executive strength at medium-size companies, and they're very eager to bring in executive talent," says Rothman.

By this time next year, both the economy and the job market could rebound. But in the interim, we've asked various experts which industries are expected to stay relatively strong in 2002:

Health Care: This is the industry on top of most experts' lists of where to find executive level jobs. Hospitals, care providers and payers, pharmaceutical companies, and home health care agencies will all need experienced executives. In addition to the essential nature of health care, factors such as the aging population, developments in technology, and the introduction of new drugs and products are driving demand for health care executives. "That whole area is a very strong area of the economy," says Challenger. "It's a field that's withstood

recessionary forces and continued to grow, and government is continuing to spend money there."

Because of the explosive growth of the pharmaceuticals industry in the past decade, there are a lot of millionaires beginning to retire at age 45 to 55, which will create a new surge of hiring, says Kevin Butler, global health care practice managing partner for Heidrick & Struggles in Greenwich, Conn. One of his clients is in the process of hiring hundreds of vice presidents and higher level executives to replace those expected to leave in the next 12 months—all at \$200,000 salaries and up. Pharmaceutical companies also need experts in manufacturing and quality control, sales and marketing, and consumer branding.

Intelligence and Security: In the first two weeks after the September 11 terrorist attacks, the Central Intelligence Agency (CIA) received nearly 10,000 résumés from prospective employees on their Web site alone, and job seekers also flooded the Federal Bureau of Investigations (FBI) and other government agencies with queries.

Likewise, private security companies are hiring at all levels to meet the increased demand for security services from both existing and new clients. "We're certainly hiring people with a wide range of skills, and we're also working our existing folks more than usual to meet our clients' expectations," says Larry Curran, a vice president of Pinkerton Consulting and Investigations in Boston. One of the oldest security firms in the country, Pinkerton is hiring everyone from uniformed security officers to design engineers who work on electronic security devices and other technologies that help secure facilities and protect employees.

Biotechnology: With the American public donning gas masks and stockpiling medicine, companies that help fight bio-warfare will clearly grow. Even before September 11, biotech was a burgeoning industry, with a tremendous increase in the number of products in line for approval by the Food and Drug Administration (FDA). "That means that clinicians, product managers and

clinical research specialists are all being hired because they're essential to complete those programs," says Butler.

There is also continuing investment in new startups. Of course, each of these new companies needs a team with a CFO, CEO, and so on, as well as employees with scientific backgrounds. For example, companies like Millennium in Cambridge, Mass., Curagen in New Haven, Conn., and Chiron on the West Coast, are all hiring.

Bankruptcy Law: As a result of the myriad business failures of the past year, large law firms are aggressively recruiting attorneys at all levels to build their bankruptcy practices. "It's still

"There's a scarcity of executive strength at medium-size companies and they're very eager to bring in executive talent."

*- Andrea Alfus Rothman
President, Wenroth Group*

the hottest sector in the greatest demand," says David Sarnoff, a recruiter for Schneider Legal Search in New York. "There seems to be an expectation that there are many large filings to come and law firms want to be in a position where they can accommodate as much as possible." Likewise, other sections of litigation have remained strong through this market. "When there's a dip economically, litigation tends to heat up as a result of business transactions that fall through," says Sarnoff. "People are trying to get their money back and make someone finish a deal."

Education: From May through October of this year, no sector has witnessed a greater surge in job listings on Netshare than education. Most jobs are in either corporate education or e-learning, which refers to classes

hosted via the Internet or through an array of multimedia tools, including video, audio, and CD-ROMs. Many corporate universities and e-learning companies were thriving before September 11, but the attacks stepped up demand for these services because people are wary of traveling to attend conferences and seminars. As a result, companies are gearing up by hiring sales and marketing people, among others.

"We're seeing a lot more interest in our type of technology," says Ellen Slaby of Centra, an e-learning software and services provider hiring people for various strategic roles within the company. "People are looking to stay competitive and stay connected with customers and partners, and they want to look into different ways of doing business."

Defense: It goes without saying that times are flush in the defense industry, which hasn't seen such a boom since the Reagan era. Congress appropriated \$40 billion in emergency appropriations for defense rescue and recovery and antiterrorism efforts, and the Pentagon requested an additional \$17 billion back in October to boost national defense. On October 26 Lockheed Martin won the biggest defense contract in history, to provide up to 3,000 Joint Strike Fighters to the armed forces.

Data security: While the information technology and semiconductor sectors remain flat markets for job seekers, anything to do with security is booming. So-called anti-intruder technology designed to secure Web sites or other business-to-business products that reduce risk on web sites or internal networks, are very much in demand. "In addition, there's been a renewed emphasis on disaster recovery, a label that refers to exactly what happened September 11, when your data gets destroyed," says Kevin McNerney, global managing partner for the international technology practice of Heidrick & Struggles in Tysons Corner, Va. "All of Wall Street has always had that, but lots of other businesses are now thinking that's important." ■

{ MICHELE PULLIA TURK is a freelance writer specializing in lifestyle issues. }

BUT THEY SAID EVERYONE SPOKE ENGLISH

BY PATRICIA L. KURTZ

An executive of a large U.S. chemical company was delivering a speech in English on the high cost of industrial accidents to a group of international managers. All had studied English. As he elaborated the human, environmental, and financial toll of these types of disasters, he noticed that many audience members seemed to be grinning. He assumed the broad smiles signaled agreement. At the end of his remarks, however, he was met by silence. There were no questions or remarks from the listeners, only a polite "thank you" from the chair.

What had happened? The audience seemed interested, even receptive. Unfortunately, instead of agreement, the executive later found out that the "broad smiles" reflected bafflement, as well as a Herculean effort to follow and understand the speaker.

ARROGANT OR UNAWARE?

Approximately one billion of the world's people have studied English as a foreign or second language. It is the language of business and diplomacy. It is the world's most studied foreign language. Precisely because English is the international language, we simply expect we'll be understood. We operate on automatic pilot, speaking in Rome, Italy as though we were in Rome, New York. This behavior can strike our international colleagues as arrogance, but it's usually a lack of awareness. Most native English speakers have never had to speak another language beyond the tourist basics, so we don't appreciate how hard it can be to function in another language. The following are some tips to follow the next time we give a presentation or do business in English with a cross-lingual audience of non-native English speakers.



BE CONSCIOUS OF USAGE

Non-native English speakers understand each other better than they understand us. They have learned English rather than acquired it. They share a smaller pool of words and don't know many culture-bound expressions we generously sprinkle throughout our speech. We can make our English easier to follow by being more conscious of the English we use:

Avoid idioms. Ask most non-native English speakers to "push the envelope" and they will go in search of stationary supplies. Most idioms don't make it around the world once before being replaced by new, equally bewildering ones.

Avoid jargon and acronyms. Jargon and acronyms become speech habits, but they baffle the cross-lingual listener. Acronyms that will be used repeatedly should be explained (WHO i.e., The World Health Organization) and represented on a visual aid.

Avoid complex sentences. A myriad of dependent, coordinate, subordinate, and relative clauses makes sentences hard to follow. Favor simple or compound sentences where the relationship between subject and verb is clear.

DELIVERY TIPS

Speak slowly and PAUSE. The major complaint of non-native English speakers is that mother-tongue English speakers talk too fast and run words and sentences together. Pausing between thoughts, at the ends of sentences or phrases, after each item on a list, or to introduce a new point is effective in all communication situations. It is essential in cross-lingual ones.

Perhaps the most important communication skill is attitude—a great communicator needs a genuine desire to understand and to be understood. In cross-lingual encounters, though we may be the guests geographically, we are the hosts linguistically. The best way to be a gracious host is to speak English with greater clarity and sensitivity. ■

{ PATRICIA L. KURTZ is a communications consultant. }

Meredith Ashby and Stephen Miles, business analysts in Heidrick & Struggles' Global Center of Excellence, have talked with hundreds of CEOs, senior managers, academics and management experts on the topics of leadership, governance and human capital as part of the company's ongoing efforts to identify, create and provide cutting-edge thought leadership for clients' intellectual and human capital development. The Heidrick & Struggles' Global Center of Excellence is led by one of the company's vice chairmen, John T. Gardner. Oxford University Press will publish the Heidrick & Struggles groundbreaking book on leadership in the spring of 2002.

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KOREA

HYUNDAI GETS HOT

Better quality and design are speeding its bid to be a global player

When Chung Mong Koo became CEO of Hyundai Motor Co. in March, 1999, the auto industry yawned. Chung, the eldest living son of Chung Ju Yung, Hyundai's late founder, was widely deemed a colorless executive who would promote the status quo by flooding the market with cheap knockoffs of Japanese cars. Chung, 63, had spent much of his career running Hyundai's after-sales service division, a post that required no overarching vision or boardroom combat. Was this the man to breathe new life into a company that was losing money and had a reputation for poor quality?

Turns out he was. Chung had a real agenda, and he was prepared to use unconventional means—at least for a Hyundai exec—to ensure its success. Days after he took over, Chung visited Hyundai's sprawling plant at Ulsan on the southeastern tip of the Korean peninsula. To the shock of his employees, Chung strode onto the factory floor and demanded a peek under the hood of a Sonata sedan. He didn't like what he saw: loose wires, tangled hoses, bolts painted four different colors. On the spot, he demanded that the bolts be painted black and ordered workers not to release any car unless all was orderly under the hood. The plant chief recalls Chung fuming: "The only way we can survive is to raise our quality to Toyota's level."

Today, Chung is well on his way. Thanks to improved qual-

ity and design, Hyundai sold 1.34 million vehicles in the first 10 months of this year, up 8% over the same period in 2000. Much of the action was in the U.S., where, by the end of November, sales had hit 322,000, up 42% from 2000. Worldwide Net profit for 2001 is projected to reach \$860 million on revenues of \$13.2 billion, up 65% year-on-year, with the U.S. responsible for 40% of that. The stellar results have prompted Chung to authorize the opening of Hyundai's first U.S. plant, though no date is set. And increasingly, he is moving the design process to America, too, including a planned test track in the Mojave Desert.

TURNING A CORNER. The encounter at Ulsan was the opening salvo in Chung's battle to turn the Korean auto maker into a global player. Within months, Chung established a quality-control unit. He shuffled management, promoted a pair of U.S. designers, and sold 10% of Hyundai Motor to DaimlerChrysler with the aim of building a strategic alliance. The partnership has yet to bear fruit, but it eventually could give Hyundai access to technology. Most important, Chung poured money into research and development—\$1.4 billion this year—to build cars that not only compete on price but deliver on quality. And he chose to make the U.S. the key battleground.

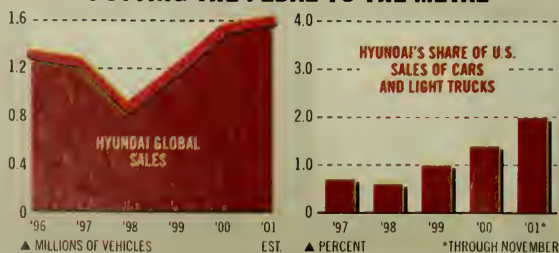
That required a radical shift in corporate mindset: For the first time, Korean execs were ordered to act on key

recommendations made by their American colleagues. At the same time, Chung was determined to build cars that would appeal to U.S. drivers. To that end, he handed his California design team control over the company's first sport-utility vehicle, the hot-selling Santa Fe.

In 1991, Hyundai had opened a design studio in Fountain Valley, Calif., and hired Andrew Kort, formerly of Chrysler and Mercedes-Benz, and Derek S. Sancer, who had worked at ASHA Corp., a small component designer in Santa Barbara, Calif. Kort and Sancer were recruited to design concept cars for the auto-show circuit. In 1995, Hyundai execs told Sancer and Kort the company needed an SUV. Midway through devising a concept car based on the Ducati motorcycle, the designers transferred the theme, with its distinctive exoskeleton, to what is now the Santa Fe.

As the designers were tinkering, Toyota Motor Corp. and Honda Motor Co. rolled out the RAV4 and CR-V, auto-chassis SUVs of the same kind Hyundai was developing. Hyundai bought several of each and tore them apart to analyze them and devise fea-

PUTTING THE PEDAL TO THE METAL





DRIVING FORCE

Chung has charged up Hyundai with winners such as the Santa Fe

"It's not just the price, it's about styling, value, and warranty." Not that the impact of price should be underestimated: The Santa Fe sells for an average of \$21,000. When a friend asked him why he bought one, Arnie Goodman, a roofing-company manager in Southfield, said: "When I drive down the street, I've got leather, a CD player, four-wheel drive, and anti-lock brakes. The only thing missing is the \$42,000 price tag."

Encouraged, Hyundai's next step is to cement its place in the biggest car segment: the family sedan. Hyundai is focusing its marketing efforts on the Sonata, which competes with the top-selling Honda Accord and Toyota Camry. After giving the Sonata a facelift and a new engine, Hyundai moved 5,923 units in November versus 2,881 a year earlier. One reason for the robust sales is that the V-6 Sonata, at about \$20,000, costs about the same as four-cylinder versions of the Accord and Camry.

STIGMATIZED. So far, so good. Chung & Co. have rescued Hyundai's image and designed cars that people want. The next question is whether customers will stick with Hyundai when they decide to buy another vehicle. Fact is the Hyundai name continues to turn some people off. When the company conducted a blind test for the Santa

Fe, customers who liked the car said they'd expect to pay up to \$10,000 less because it was a Hyundai.

Another question is the role of Hyundai's famous 10-year drive-train warranty in the U.S. A brilliant stroke, it convinced Americans that they should give Hyundai cars one more chance. At some point, though, the company will have to pull the plug because the warranty will be too costly to maintain. Finbarr O'Neill, president and CEO of Hyundai Motor America, says the warranty will continue through the 2005 model year. Will sales plunge once it's withdrawn? Not likely, says O'Neill. "The warranty allowed us to get on people's shopping lists," he says. "But warranties don't sell cars."

Despite all the progress made under his stewardship, Chung still has his crit-

servatives—they felt the Santa Fe looked crumpled—to preserve Kort and Sancer's design. "Some may not like it," says Kort. "But at least they can see the difference."

A key move was the decision to feed the American driver's hunger for horsepower. The RAV4 and CR-V came equipped only with two-liter, four-cylinder engines. The Santa Fe offers a 2.7-liter, V-6 engine. "It turned out to be a winning factor," says Lee Hyoungh Keun, who runs global marketing. Indeed, the Santa Fe was a bona fide hit when it debuted in the autumn of 2000. "The Santa Fe was well received right out of the blocks," says George H. Glassman, a Hyundai dealer in Southfield, Mich.

ures that would set the Santa Fe apart. "We looked at every interior and exterior component to find a way to improve on it," Sancer recalls. Innovations ranged from a cupholder sufficiently capacious to hold a liter soft-drink bottle to extra power points for cell phones.

Hyundai needed to make sure the Santa Fe stood out on the road, too. Hence the decision to widen and lengthen it—a shrewd move because the RAV4 and CR-V were criticized for being too small. Sancer and Kort also gave the vehicle distinctive, muscular curves. Back in Korea, Park Jong Suh, a design chief, recalls battling company con-

ics. Some fret that his ambitious expansion plans could prompt Hyundai to put market share before profits—in the hoary *chaebol* tradition. Indeed, Chung aims to boost the combined capacity of Hyundai and Kia this decade to about 5 million units a year from some 3 million now. Hyundai argues that it must make 1 million vehicles per platform to survive. But that strategy could leave the auto maker with a lot of unsold cars.

Still, there's no denying that Chung has transformed Hyundai Motors. J.D.

Powers, the California-based arbiter of auto excellence, reports that Hyundai's quality has jumped 28% over the past four years, versus 14% for the industry. And the company's customers are more upscale. O'Neill says the people who now shop for Hyundais also look at Hondas, Nissans, and Toyotas. And dealer Glassman says he gets Lincolns and Mercedes as trade-ins.

Back in Korea, Chung exudes confidence. "Our prospects are good as long as we offer value for money," he says.

Chung aims to make Hyundai one of the top five carmakers on the plan before 2010. To do so, he will have to resist the temptation to overreach—the fatal mistake of many a Korean executive. For an example of what can go awry, Chung need look no further than his father, the man who founded Korea's top conglomerate—only to see it crumble under a mountain of debt.

By Moon Ihlwan in Seoul, with Larry Armstrong in Los Angeles and Katie Kerwin in Detroit

JAPAN

CLEANING UP THE BANKS—FINALLY

Tough audits may turn the tide in the bad-loans mess

Few Japanese have ever heard of Hirofumi Gomi and Takeshi Go Kimura. Yet in Tokyo banking circles, they are loathed and feared. Gomi is the head of the Financial Services Agency's inspection division. Kimura is a brash former Bank of Japan official who is president of KPMG Financial K.K. Co., the Japanese branch of the international accounting firm. No ordinary bean-counter, Kimura has the ear of Prime Minister Junichiro Koizumi. Together, Kimura and Gomi are triggering panic attacks among Tokyo's pinstriped set.

Why? Gomi's FSA, which oversees Japan's banks, has its 360-member inspection division conducting in-your-face examinations of the loan books of Japan's major banking groups, including giants such as Mizuho, Mitsubishi Tokyo, and Sumitomo Financial. In the past, such audits had the intensity of a croquet match. Nobody ever asked the obvious question: Are any of your biggest borrowers about to fall on their faces?

As a result, banks spent years glossing over the true extent of their problems. Many analysts suspect Japan's bad loans approach \$1 trillion. The official estimate is \$135 billion.

Few believed regula-

tors had the guts to force the real numbers into the open. But they are now. In announcing results for the half year ended in September, Japan's top 13 banks tripled earlier projections of the bad debt they are holding. Top lender Mizuho says it will write off \$16 billion in dud loans. In all, the top banks will set aside an additional \$50 billion as reserves against nonperforming loans for the fiscal year ending in March.

CRACKING DOWN. This suggests the arm-twisting by Team Gomi is having an impact. And the fact that the auditors have the freedom to ask hard questions is due to some hard lobbying by Kimura. In private meetings with Koizumi and top Liberal Democratic Party brass, he argues that the banks need to take off the kid gloves when dealing with their major clients. Until the banks reveal the true value of their loans to the 30 or so biggest borrowers, he says, "they are avoiding reality."

The FSA auditors are providing that reality check. Since early November, they have spent hundreds of hours poring over the banks' own evaluations of borrowers' balance sheets. The goal is to flush out the bad

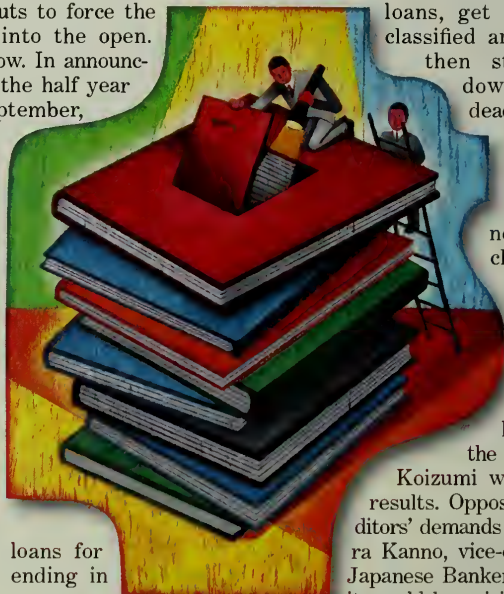
loans, get them properly classified and provisioned, then start to crack down on chronic deadbeats. Already, the FSA figures that 15% of the loans at the top 10 banks need to be reclassified, which means declaring many "problem loans" as nonperforming.

With the FSA blood hounds at work, the question is what Koizumi will do with the results. Opposition to the auditors' demands is building. Akira Kanno, vice-chairman of the Japanese Bankers Assn., argues it would be suicidal for banks to

damage vital corporate relationships by cutting companies off at the knees. International Monetary Fund Asia-Pacific Director Kunio Saito calls such statements "an excuse for not taking action."

Koizumi, whose reform drive has foundered of late, needs the audits as political cover for an unpopular bailout of the banks. The agency likely to play the central role is the government's Resolution & Collection Corp. The RCC plans to issue bonds for as much as \$100 billion that will be purchased by the Bank of Japan. The RCC will then use the proceeds to buy bank loans from lenders and come down hard on delinquent borrowers—either shutting them down or refinancing their debt on much more stringent terms. Hard-hit industries like construction may try to head off such action. But Koizumi's strategy, no doubt with advice from Gomi and Kimura, is clear: He knows that before the bankruptcies and mass layoffs can begin, the auditors have to reveal the true extent of the banking fiasco.

By Brian Bremner in Tokyo



GETTING A HAIRCUT

Estimated FY 2002 debt write-downs for Japan's biggest banks

	BILLIONS
MIZUHO FINANCIAL GROUP	\$16.0
UFJ GROUP	16.0
SUMITOMO MITSUI	8.0
BANK OF TOKYO-MITSUBISHI	3.9
DAIWA	1.3

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GERMANY

THE BATTLE FOR THE GERMAN TV SCREEN

Tough rivals train their guns on John Malone

Liberty Media Corp. Chairman John C. Malone knew how to make political allies when he toured Germany in mid-November to push his plans to build up the nation's cable television network. The Englewood, (Colo.)-based cable czar dangled a promise of 10,000 new jobs in a country with rising unemployment and elections approaching next year. Sure enough, Malone won an audience with power brokers such as Bavarian Prime Minister Edmund Stoiber and even Chancellor Gerhard Schröder. "He really knows his business," says Bernd Schipphorst, media adviser to the city of Berlin, who lunched with Malone and Berlin Mayor Klaus Wowereit at the Berlin Capital Club, a tony rooftop restaurant.

Malone has some powerful adversaries as well. One of the most notable: Thomas Middelhoff, CEO of German media giant Bertelsmann, which controls RTL Group, Germany's biggest broadcaster. Associates say that Malone and Middelhoff have a cordial relationship, but business is business. RTL Group, partly owned by British media giant Pearson PLC, is making an all-out effort to block Liberty Media from getting regulatory approval for plans to buy Deutsche Telekom's cable assets and upgrade the system to offer hundreds of channels and Internet access.

HIGH STAKES. If Malone loses this showdown, he faces a possibly fatal setback to his plans to become the Continent's biggest cable operator. Besides the Deutsche Telekom assets, Malone is poised to gain ownership of a majority stake in UnitedGlobalCom Inc., parent company of Amsterdam-based United Pan-Europe Communications (UPC). The deal requires approval by the Securities & Exchange Commission, and, due to its complicated financial structure, Malone won't have direct control over UPC's 7 million European subscribers. But it gives him a greater platform to boost distribution of his own programming holdings, which include the Discovery Channel and stakes in AOL Time Warner and Rupert Murdoch's News Corp. Malone would also get huge economies of scale buying equipment such as set-top boxes.

But the plan inspires fear among Mid-

delhoff and other German broadcasters, who greatly depend on cable to distribute their programs. They worry Malone will favor programming he owns, including a stake in USA Networks, and push rivals' programs way down the remote control. "There will be somebody controlling the cable, the access, and the content," says Didier Bellens, CEO of RTL Group, which owns all or part of five commercial TV stations in Germany.

Indeed, if the UPC and Deutsche Telekom deals both get approved, Malone would have a grip on over two-thirds of Germany's cable market of 18.2 million subscribers. It doesn't make competitors feel any better that Liberty is interested in a stake in Premiere, Germany's only major pay-TV venture. It is controlled by Munich-based Kirch Group and has rights to a lot of sports programming. "He's an outsider coming in, and he's taking too much," says Paul O'Donovan, a senior analyst at Gartner Group in London. To top it off, Richard J. Callahan—another Colorado-based cable magnate—has acquired many of the German cable assets that Malone doesn't own. Malone



MALONE: Will regulators block his ambitious plans?

and Callahan have close ties, which add to the Germans' fears.

The combatants are lining up outside Germany's Cartel Office in Bonn, which must approve Malone's \$4.9 billion purchase of the Deutsche Telekom network. A decision is scheduled for Jan. 7. With his powerful allies and big bucks, Malone can probably win approval. The question is what the terms may be. Cartel Office officials indicate that they would like Liberty to upgrade the cable network so it can also carry telephone voice traffic and so expand German consumers' phone options. But that would double or triple the cost for Liberty, which plans to spend just \$13 per home to allow digital channels on upgraded cable.

Detractors paint Malone as an unscrupulous outsider who will jack up fees and break his promises. Liberty officials privately counter that RTL's campaign is mostly for show and that all rhetoric aside, Bertelsmann isn't a hostile as it makes out. Maybe, but RTL Group did just cancel a contract with the Berlin office of Kohtes Klewes after the PR firm agreed to represent Liberty. If Malone gets the regulatory nod, RTL and other competitors can appeal in court, which could delay Liberty for more precious months. With so much at stake, this fight could get nasty.

By Jack Ewing, with Christine Tierney in Frankfurt, and Ronald Grove in Los Angeles

Malone's European Empire

COUNTRY	CABLE SUBSCRIBERS
GERMANY	13.3 MILLION SUBS*
BRITAIN, IRELAND	6.9 MILLION SUBS**
THE NETHERLANDS	2.4 MILLION**
POLAND	1.3 MILLION**
HUNGARY	704,800**
AUSTRIA	493,200**
FRANCE	433,900**

*Includes pending deals with Deutsche Telekom and investment in United Pan-Europe Communications (UPC)

**Includes investments in BSkyB and Telewest

***Investment in UPC

Data: Company reports



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TAKEOVERS

SPIFFING UP BROOKS BROTHERS

Can Claudio Del Vecchio turn the venerable chain around?

On Dec. 1, just a week after he snapped up Brooks Brothers Inc. for a song, Italian entrepreneur Claudio Del Vecchio toured the clothier's flagship store on Madison Avenue in Manhattan, checking out the merchandise, the staff, the shoppers. He was especially heartened to see an Austrian diplomat being fitted for a tuxedo. "Brooks Brothers still makes great suits for presidents and ambassadors," says Del Vecchio, who over the past four years has assembled a portfolio of specialized fashion companies in the U.S.

Indeed, Del Vecchio has long wanted to get his hands on Brooks Brothers, which has outfitted powerful and famous men from Clark Gable to John Kennedy. He nabbed the chain for only \$225 million, less than one-third what British retailer Marks & Spencer paid for it in 1992. Brooks Brothers profits have dropped as a foray into casual clothing blurred the brand's identity and product quality slipped. Del Vecchio is convinced that its classic cachet can be revived. Brooks' traditional line of button-down shirts, suits, and ties never lost its appeal for this 44-year-old Italian, who landed in the U.S. in 1982 to help boost exports at his family's \$1.6 billion eyeglass business, Luxottica Group.

CASUAL FRIDAYS. Still, Del Vecchio agrees that the 183-year-old American menswear icon needs an overhaul. That means a renewed focus on classic clothing. "Brooks Brothers forgot about the suit guy—the one they dress five days a week," says Del Vecchio. He plans to invest heavily in technology to replace outdated logistics systems—a vital factor in increasing efficiency that Marks & Spencer neglected. "Brooks Brothers

has been sliding for years," says Kurt Barnard, president of *Barnard's Retail Trend Report*, a U.S. trade publication. In the first half of fiscal 2002 (ending Mar. 31), it reported an operating loss of \$1.1 million, compared to a profit of \$3.6 million last year. Retail analyst Tony Shiret at Credit Suisse First Boston in London forecasts flat sales of \$639 million for the year as a whole.

Yet Brooks Brothers' new owner cannot ignore the trend toward casual wear, which has penetrated even such bespoke bastions as investment banks and law firms. The retailer must draw new and younger

DEL VECCHIO: *Stylish*



DEL VECCHIO'S AMERICAN ADVENTURE

NOV. 23, 2001: Acquires Brooks Brothers for \$225 million in cash from Marks & Spencer. The 183-year-old men's retailer had sales of \$636 million in fiscal 2001.

FEBRUARY, 2001: Buys women's sportswear and accessories maker Adrienne Vittadini, with sales of \$25 million.

JULY, 2001: Purchases Carolee Designs, a \$35 million jewelry and accessories retailer.

JANUARY, 1998: Assumed ownership of ailing women's apparel chain Casual Corner from his father's company Luxottica. Retailer had \$820 million in sales last year.

Data: Retail Brand Alliance

customers into its 160 U.S. shops with relaxed clothing that is fresh but does clash with its traditional image. Managers at Retail Brand Alliance, Del Vecchio's Enfield, Connecticut, holding company, say a new line of sportswear made from lighter fabrics and all-cotton, no-wrinkle shirt are a good start. "Brooks Brothers is about style, not fashion. It's about always looking right in classic garments instead of being in fashion," says Lois Huff, vice-president of Retail Forward Inc., a Columbus (Ohio) retail consultancy.

Del Vecchio's ace is his talent for managing production, logistics, and suppliers—skills honed during his years at Luxottica. He now checks on factories that supply his other fashion companies during quarterly jaunts to Europe and Asia and maintains a staff of 10 in the Far East, mainly to monitor quality. "He is intimately involved in sourcing. Very few CEOs of specialty retailers work closely with suppliers," says Mark Shulman, chief operating officer of Retail Brand Alliance.

Del Vecchio's hands-on style, along with a \$100 million investment in technology to upgrade supply-chain management, were key factors in his overhaul of Casual Corner, the midprice women's-clothing chain that he bought from his father in late 1997. Casual Corner posted a \$50 million profit for the 2001 fiscal year.

Del Vecchio figures the turning around Brooks Brothers will take at least two years. If successful, he will expand abroad. Italian shoemaker Diego Della Valle plans to open a Brooks Brothers store in Milan next July under a preexisting agreement. "There's a huge passion for the Brooks Brothers brand in Italy," says Della Valle. Through another licensing agreement, the company already has some 70 shops in Japan and Hong Kong. Given the sales slump in traditional menswear, "the only way to grow is to take Brooks Brothers international," says Retail Forward's Huff. For Del Vecchio, that just means coming full circle.

By Gail Edmondson
in Rome



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THE MIDEAST: IS ARAFAT ON THE WAY OUT?

Palestinian leader Yassir Arafat's standing in the world is rapidly collapsing. In the wake of suicide bombings on Dec. 1 and 2 that left 25 dead, Israeli helicopter gunships shot up Arafat's own prized helicopters and bombed his headquarters and other trappings of power.

Worse, the Bush Administration, which only two weeks ago was talking up the idea of a Palestinian state, seems close to buying into the Israeli argument that Arafat and his coterie are part of the global terrorist network that Washington wants to stamp out. White House spokesman Ari Fleischer all but signaled the Israelis to blast away on Dec. 3. A day later, the Administration followed up by freezing the assets of three financial groups said to be linked to the Islamic terrorist group Hamas, which claimed responsibility for the suicide attacks.

These events could well bring a turning point in the Middle East. Egypt and Jordan are unlikely to come to Arafat's rescue. But if Hezbollah, the Lebanese Shiite group, attacks Israel to support Palestinian militants, the Israelis might strike at Syrian military installations in Lebanon, risking wider war.

The shock waves from these outbursts will probably hit the Palestinians hardest, however. Arafat faces the choice of cracking down on the Islamic extremists or having the Israelis rain destruction on the dusty slivers of territory that he is expected to police. He could even become a target for an Israeli missile or, more likely, find himself bundled into exile.

IN A VISE. Prime Minister Ariel Sharon may not go that far because a serious escalation could prompt the resignation of Foreign Minister Shimon Peres of the Labor Party, whose presence strengthens his coalition. Still, Arafat's position is dire. It is not clear that he has the power or the will to satisfy Israeli demands to end the suicide bombings and jail key militants. And if Arafat succeeds in halting the violence,

that may further blacken his image at home because the Islamists are increasingly popular. Arafat doesn't have much to persuade the public to turn against Hamas and its bombers. It seems unlikely Sharon will make an offer like the deal from his predecessor, Ehud Barak, that Arafat spurned at the end of the Clinton Administration.

With little to gain from moderation, the extremists rule the day. Ramallah pollster Khalil Shikaki notes that in recent student elections at al Najah University on the West Bank, the Islamists trounced candidates from Arafat's Fatah faction by 60% to 34%. Student ballots are a widely watched barometer. If this trend continues, says Shikaki, "the Islamic forces will become the mainstream in Palestinian society in two to three years." Hamas and Islamic Jihad want a fundamentalist Islamic state to replace Israel.

Arafat's only hope is that he passes the test by smashing the terror groups and that the U.S. resumes its efforts to broker peace. The Administration appointed two Middle East envoys, Assistant Secretary of State William J. Burns and retired General Anthony C. Zinni. The bombings sabotaged Zinni's first mission.

If serious negotiations could be restarted, pollster Shikaki thinks that Arafat might be saved. Otherwise, a younger, more militant group consisting of Islamists, perhaps allied with armed elements of Fatah, may come to dominate the West Bank and Gaza. Some Israeli officials, possibly including Sharon, think the militants might be preferable to Arafat because at least their intentions would be clear and the Israelis could deal with them as determined enemies. But a post-Arafat Palestine would probably be even more violent than it is now. Peace seems very far away.

By Stanley Reed in London and Neal Sandler in Jerusalem



CORNERED: No good option

GLOBAL WRAPUP

RUSSIA'S TRUCE WITH OPEC

► After weeks of resisting OPEC's demands, Russia decided on Dec. 5 to slash its crude-oil exports by 150,000 barrels per day, starting on Jan. 1, 2002. That 5% cut, together with reductions by non-OPEC members Norway, Mexico, and Oman, could trigger a 1.5 million-barrel-a-day drop in exports by OPEC. Analysts say the cutbacks should hold world prices steady at an average \$19 per barrel next year—if not higher. The Russian move headed off a price war threatened by

OPEC after Moscow offered to slash exports by just 50,000 barrels per day in the fourth quarter.

But Russia may not stay in OPEC's good books if its oil companies bend the rules. "Russian producers are going to continue to try to increase market share," says James Henderson of Renaissance Capital. "This is an ongoing battle between Russia and OPEC."

AN AMERICAN IN THE HOT SEAT

► A post-Taliban interim government will be installed in Afghanistan on Dec. 22, thanks to an agreement

reached in Bonn after talks among Afghan opposition groups. Heading the government will be Pashtun tribal leader Hamid Karzai, who was backed by the U.S. and various Afghan factions. Now, attention will turn to rebuilding the country. Along with the U.N. and international lenders, a key player will be the State Dept.'s point man in Afghanistan, James F. Dobbins. The 59-year-old career diplomat, who has experience in Kosovo, Bosnia, Haiti, and Somalia, will work with Karzai to bring in aid and keep the government from unraveling.

THE INTERNET

EXCITE@HOME: A SAGA OF TEARS, GREED, AND EGO

Its fall may well be a cautionary tale for the future of broadband

By PETER ELSTROM



In August, Patti S. Hart made a last-ditch effort to save Excite@Home. The chief executive at the provider of speedy Internet connections set up a videoconference call with top executives from AT&T, which had a controlling stake in Excite@Home. She told AT&T CEO and Excite@Home board member C. Michael Armstrong and other AT&T officials that Excite@Home had \$100 million less in cash than her execs had told her to expect just weeks earlier. She needed financial help from AT&T to avoid bankruptcy. Armstrong said a cash infusion was out of the question. Hart pleaded and tears welled up in her eyes, according to one former exec close to Hart. Armstrong was not swayed. "After that, it was over," says the former exec. "It was just a matter of who turns out the lights."

That flick of the switch could be just weeks away. After filing for bankruptcy protection on Sept. 28, the company is auctioning off its few remaining assets and plans to shut down on Feb. 28. Already, a bankruptcy judge in San Francisco has allowed Excite@Home to shut off service to 850,000 AT&T customers—in a high-stakes game the startup is playing to force the phone giant to cough up more money. AT&T is refusing payment, and few expect Excite@Home will be saved. When the judge's gavel falls again, the startup that was once worth \$35 billion could go for about \$350 million, 1% of its peak market cap.

Eighteen months after the Internet bubble burst, it's hard to muster sympathy for yet another Net flameout. But this was no ordinary Web startup. Un-

like the thousands of fledglings with harebrained ideas, Excite@Home could have become a Net powerhouse. It held a trump card: the exclusive right to offer broadband Net connections over the cable-TV networks of most top cable companies. Today, it claims 4.2 million high-speed subscribers, more than any other company in the U.S. What's more, it possessed the Excite portal, one of the most popular gateways to the Internet—and a challenger to the gateways of Yahoo! Inc. and America Online Inc. To top it off, it had big-moneybag backers: AT&T, Cox, Comcast, and Silicon Valley's premier venture-capital firm, Kleiner Perkins Caufield & Byers. "It looked like a marriage made in heaven," says Ron Conway, a founding partner of venture firm Angel Investors, which has no financial stake in the company. "I thought it was brilliant."

SHARPIES. The company also boasted an all-star team. Kleiner Perkins' powerful venture capitalist L. John Doerr helped set up both Excite and

Bell, who brought his skills in documentary filmmaking and traditional magazines to the new-media world of the Net.

So why is Excite@Home in ruins? Blame it on a lethal combination of management missteps, clashing egos, and old-fashioned greed. In the end, the cable companies that backed Excite@Home and took more than \$1 billion from investors to finance it decided to walk away, leaving public investors to pay the price. Cox Communications Inc. and Comcast Corp., which had pledged to keep all of their broadband customers on Excite@Home's network through June, 2002, negotiated early exits so they could provide their own service.

The most serious questions, however, swirl around AT&T. The long-distance giant controlled the startup, thanks to its 74% voting stake and its 6 out of the 11 seats on the board. Several developments over the past year raised questions about whether those directors were looking out for

@Home, then supported their merger in 1999. Cable mogul John C. Malone played a critical role in establishing @Home and was a longtime member of the board. So was AT&T's Armstrong. And the company's CEOs were sharpies: Thomas Jermoluk, who had run Silicon Graphics Inc. in its heyday, and George

Excite@Home and its shareholders or whether they pushed the company into bankruptcy so AT&T could buy its assets for very little. At minimum, AT&T pushed the company to spend heavily on its network earlier

us year, refused to chip in more money when cash ran low, and then offered to buy Excite@Home's network for just \$307 million—before withdrawing the bid just days ago. "There is a rightful concern that AT&T could have stepped up and supported the company in its time of need—or tried to pick up the assets on the cheap out of bankruptcy," says Andrew Watt, a debt analyst at Standard & Poor's.

AT&T says the idea that it drove Excite@Home into bankruptcy is ludicrous. After all, its execs point out, the long-distance giant paid \$3.5 billion for its controlling stake in the company—then lost all its money. "We've always supported this company because we believed strongly in the broadband marketplace," says John Petrillo, T&T's executive vice-president for corporate strategy and a former Excite@Home board member. What caused the company's demise, he says, were management mistakes, a steep slide in online ad-

At their April, 1999, peak, the shares of Excite@Home traded at \$94.66. Now, they fetch 3¢

LEFT: JERMOLUK'S @HOME AND BELL'S EXCITE MERGED IN 1999.
RIGHT: AT&T'S ARMSTRONG

vertising, and the persistent quality issues that alienated cable outfits. And AT&T was under no obligation to bail out the company with cash. "We didn't think it was a good application of AT&T shareholder money," he says. Armstrong, Jermoluk, and Hart declined to comment for this article.

Indeed, Excite@Home execs didn't do themselves any favors. Despite their strong reputations, former CEOs Jermoluk and Bell made loads of mistakes. Most damaging, they blew millions on investments and acquisitions—money that just might have saved the company. Example No. 1 is BlueMountain.com, an electronic greeting-card company that Bell bought in 1999—over the objections of several execs, including his chief financial officer, Kenneth A. Goldman. BlueMountain had become one of the most popular Web sites, so Excite@Home acquired it for a whopping \$780 million, including \$350 million in cash. There was just one problem: BlueMountain wasn't generating a dollar of revenue at that time and never became much of a business. It was sold in September for a paltry \$35 million. "I was very vocal about it," says Goldman, now CFO at Siebel Systems Inc. "I didn't like the business model—since there wasn't one."

HURTING. The public investors are left holding the bag. Excite@Home raised \$210 million by issuing stock and nearly \$1 billion through debt issues. The company's stock is trading for 3¢. Bondholders may get 10¢ on the dollar—or less—once the asset sales are completed. "We financed one of the great expansions of the Internet," says Michael Katto, a shareholder who has lost \$188,000 and has joined a lawsuit seeking compensation from AT&T, Cox, Comcast, and Excite@Home.

Investors aren't the only ones to get hurt. The rollout of broadband Internet service throughout the country was supposed to bring a fundamental change in the way the U.S. economy works. With lightning-quick Internet links, people were going to be able to work from home, shop from home, and perform loads of other routine tasks more

DID AT&T PUSH EXCITE@HOME INTO BANKRUPTCY?

Some shareholders and bondholders say it did

easily and quickly. The consulting firm Eastern Management Group Inc. estimates broadband may add 3.7 billion work hours to the economy each year.

Now that the biggest, highest-profile provider in the country is crashing, the promise of a broadband future is fading from sight. If the No. 1 broadband player, with so much money and corporate support behind it, cannot survive, which broadband player can? Local telephone companies and cable players will continue to roll out broadband service, but they're sure to move more slowly and charge customers more than upstarts such as Excite@Home. "It's very troubling," says William E. Kennard, former chairman of the Federal Communications Commission. "You're seeing a duopoly market develop. That's going to slow broadband down."

FAT PIPES. No one imagined such an end when @Home was launched in 1995 by Tele-Communications Inc. and Kleiner Perkins. At the time, the CEO was William R. Hearst III, grandson of newspaper kingpin William Randolph Hearst. Cox and Comcast joined the company the next year. Kleiner partner Doerr spun a magical vision of the company's potential. It would develop the technology to take advantage of the

SHAREHOLDERS CONTEND THAT AT&T...

WAS IN CONTROL When AT&T acquired Tele-Communications in 1999, it took a controlling stake in Excite@Home. Later, AT&T execs gained a majority of the seats on the company's board. AT&T was critical in naming George Bell chief executive in 2000 and picking Patti S. Hart to replace him in 2001.

URGED TO SPLURGE AT&T urged the startup to spend big to sign up new customers, build out its network, and improve service. AT&T also persuaded to hire Hossein Eslambolchi, an AT&T technical veteran, in January, 2001, to head Excite@Home's network. Eslambolchi invested heavily in equipment, just as the company was running short of cash—then returned to AT&T.

HELD DOWN REVENUES Critics say conflicts of interest led AT&T execs on the startup's board to limit its revenues unfairly. When Excite@Home's cash started to dwindle, consultant PricewaterhouseCoopers recommended that the company raise the rates it charged AT&T and other cable companies for its broadband service. The board, with AT&T holding 6 of the 11 director seats, never approved it.

DIDN'T FORCE OTHERS TO PAY Several cable companies stopped paying Excite@Home for as long as six months in 2000. The \$50 million in lost cash was a key reason the company had to file for bankruptcy on Sept. 28. AT&T was on its bills, but why didn't its execs force the other cable companies to cough up their share?

TURNED DOWN PLEA Patti S. Hart asked AT&T CEO C. Michael Armstrong for more cash in August, and he turned her down. Experts say it would have cost AT&T as little as \$100 million to have helped the company survive through the

fat pipes that cable TV used, so that consumers could surf the Net at unheard-of speeds: 50 times as fast as the poky modems of the time. The cable players would market @Home's service to their customers, and the two sides would split the revenues. @Home got 35% of the typical \$40 that customers paid each month, and the cable companies got the rest. The service was launched in September, 1996, in Fremont, Calif., and became an instant hit. "People were flagging down our trucks to get the service," says ex-CFO Goldman. In 1997, @Home went public, rais-

ing \$95 million, and quickly set out to build a national network.

In 1998, it became clear that such popularity had its price. As more customers signed up, the company's network often became overloaded, and quality deteriorated. Customers, particularly in Fremont and in Hartford, Conn., complained to local politicians. Since cable companies depend on local municipalities for their franchise, this was a grave problem. Execs at TCI and other cable outfits fretted that they could get their cable-TV licenses yanked. Screaming matches broke out during @Home board meetings, ac-

THE RISE AND FALL OF EXCITE@HOME

After the broadband Internet access provider @Home merged with portal Excite in 1999, its stock price soared to almost \$95, and its market cap topped \$40 billion. Today, the company is in ruins, and the shares are trading for 3¢.

Here's its sad saga:

MARCH, 1995

Tele-Communications Inc. and John Doerr of Kleiner Perkins establish @Home to provide broadband Net access over cable-TV networks. Cable companies Cox and Comcast become investors the next year.

SEPTEMBER, 1996 @Home launches its service in Fremont, Calif.

JULY, 1997 @Home goes public, at a split-adjusted \$5.25 a share.

JAN. 19, 1999 @Home announces it will acquire Excite for \$7 billion in stock.

MAR. 9, 1999 AT&T closes its TCI acquisition, gaining a 58% voting stake in @Home.



APR. 12, 1999 The company's stock hits an all-time high of \$94.66—as investors anticipate the combination of Excite's content and @Home's broadband service will create an America Online for the next generation of the Internet.

DEC. 6, 1999 Excite@Home hits 1 million broadband subscribers, tying as many as the competing Road Runner service and 10 times as many as the largest telephone competitor.

JAN. 20, 2000 Bell takes over as CEO from Jermoluk, who remains chairman.

SEPT. 19, 2000 With the company's shares dragged down to \$16 in the tech-stock collapse, Bell announces plans to find a replacement CEO.

AT&T REPLIES

ays its control helped
@Home. When Cox and Comcast
its board, the upstart was pulled
many directions.

efends Eslambolchi's actions,
he provided invaluable advice that
correct Excite@Home's quality
is. AT&T also picked up the salaries
Eslambolchi and his assistants.

rgues that raising rates might
given away Excite@Home's existing
ers, forcing them to look for
ost alternatives.

one giant says that
ing bills was the job of
@Home's execs, not its
members.

ays injecting more cash
t in the interest of
shareholders.

ording to two former
embers. In one session at
@Home's Redwood City
Calif.) headquarters, Leo J. Hindery Jr.,
TCI's president, and Jermoluk trad-
ed expletives. "We're their customers,"
says Dallas Clement, Cox's senior vice-
resident for strategy and development.
And we never felt like they cared about
their customers' needs."

@Home's move to acquire Excite in
1999 only added to the friction. Found-
ed by six friends from Stanford University
in 1993, Excite had grown into one of
the Web's most popular portals, compil-

ing news, stock quotes, and other in-
formation. By combining the two com-
panies, @Home chief Jermoluk and Ex-
cite's Bell hoped to create an AOL on
steroids. They would reap revenues
from connecting users to the Web and
from ads and e-commerce on the Excite
site. Jermoluk boasted that Excite-
@Home would become "the new media
network for the 21st century."

Meanwhile, AT&T was doing a deal of
its own. It was in the midst of buying
TCI, primarily so that it would have an
alternative network for local phone ser-
vice. It was only in May, 1999, when
Excite and @Home completed their
merger, that AT&T and the other cable
players fully realized the regulatory trou-
bles it would cause them. AOL and others
mounted a lobbying effort to force cable
outfits to let other Net-access compa-
nies use their networks to provide
broadband service. AOL's

"open access" argument was
this: The cable companies
had been given monop-
olies in cable TV, so they
had to let customers pick
the Internet-access service
they wanted—whether it
was Excite or AOL. Ex-

cite@Home's cable investors found them-
selves spending time and money courting
politicians, instead of building a busi-
ness. "It opened up a Pandora's box of
regulation," says Hindery.

It also created more conflicts in the
boardroom. Hindery,
the TCI president
who continued to run
the cable business af-
ter AT&T acquired it,
hated the idea of

Jermoluk's getting into the content busi-
ness. In 1999, while Jermoluk was at
an AT&T golf tournament in Pebble
Beach, Hindery negotiated a tentative
deal with Yahoo so that @Home cus-
tomers could default to the Yahoo site
instead of Excite. At a later board
meeting, Jermoluk confronted Hindery
and the deal was quashed. Cox and
Comcast, however, supported the Ex-
cite deal, pulling Jermoluk in different
directions. "That makes it difficult to
execute," says Hearst.

SPEND, SPEND. More bad deals lay
ahead. In the boom times of 1999, Jer-
moluk and Bell spent loads of cash.
Over the summer of 1999, the company
invested at least \$60 million in startups,
including Quokka Sports Inc., a Web
site. Quokka is now defunct, and the
other investments have dropped sharply
in value. On Oct. 25, they cut the fateful
deal for BlueMountain. Bell says the ac-
quisition was a product of the times.
"We had the mentality of scale," he
says. "We thought scale mattered a lot,
and we wanted to add to ours."

While Jermoluk and Bell were spend-
ing the company's cash, the stock mar-
ket was beginning to turn against them.
After hitting a high of \$94.66 in April,
1999, Excite@Home shares slid down-
ward during the summer. Investors
were concerned that if AOL won its
"open access" battle, Excite@Home
could lose its monopoly. When a news-
paper reported in August that AT&T was

negotiating a deal
with AOL to give it
access to AT&T's ca-
ble network, Ex-
cite@Home's stock
dropped 11% in one



EXCITE@HOME



Data: Bloomberg Financial Markets

2001 At AT&T's request, Bell hires
Eslambolchi, an AT&T veteran who
spent millions to improve the quality of
@Home's network.

17, 2001 The company
announces that it will miss its financial
goals for the rest of the year and that it

needs to raise
\$75 million to
\$80 million by
June 30 to con-
tinue funding its
operations.

APR. 23, 2001
Patti S. Hart is
named chairman
and CEO. Bell
resigns.



JUNE 11, 2001 The
company raises \$100
million by issuing
convertible debt to a
group led by
Promethean Capital
Group.

JUNE 19, 2001 The company raises
\$85 million from AT&T. Separately, Cox
and Comcast say that, as of Dec. 4,
they plan to stop using Excite@Home
as the exclusive provider of their
broadband Net service, a move that
could eliminate 30% of the company's
customers.

JULY 23, 2001 Excite@Home says it
needs to raise even more money to
survive through the end of the year.

AUG. 20, 2001
In an SEC filing,
auditor Ernst &
Young says there
is "substantial
doubt" the
company can
continue as

"a going concern."

SEPT. 28, 2001 The company files for
Chapter 11 bankruptcy protection.

NOV. 28, 2001 The bankruptcy court
approves the sale of most of the assets
of the Excite portal to InfoSpace for
\$10 million.

NOV. 30, 2001 A bankruptcy judge
rules that Excite@Home may cut off
service to AT&T and other cable outfits.



In the end, AT&T decided broadband was too crucial to leave in another company's hands

day, to \$38. Both AT&T and Excite@Home denied the report, but investors remained skittish. Its stock closed the year at \$42.88.

The new year brought some measure of relief for the startup. On Jan. 10, AOL and Time Warner Inc. announced plans to merge. Once AOL planned to combine with a company that owned a cable network, it stopped pressing for open access. On Jan. 20, Bell took over the CEO post from Jermoluk, who stayed on as chairman. Jermoluk said he couldn't run the company properly because he was spending so much time soothing cable partners. The previous year was "the single most difficult and painful year of my life," Jermoluk said at the time. In May, he gave up the chairman's post and became a partner at Kleiner Perkins.

In March, Armstrong realized the huge potential for broadband and decided he wanted more control over Excite@Home. AT&T boosted its voting stake in Excite@Home to 74%, up from 56% when the startup gave Cox and Comcast the right to sell their 60 million shares to AT&T for \$48 each. The way the change was announced, though, did not spell out all that it would mean. Jermoluk put out a statement saying: "We are delighted that our cable partners are committed to a long-term relationship that will provide consumers with a great broadband experience." In fact, the deal gave the cable companies an exit from Excite@Home they never had before. Starting in 2001, Cox and Comcast could give six months notice and end their exclusive deals with Excite@Home. Before then, the cable companies could not offer any other broadband services through June, 2002.

Excite@Home shareholders and bondholders point to that single change as erasing a big chunk of the company's value. Instead of keeping all their customers on the Excite@Home network through June, 2002, Cox and Comcast could terminate exclusivity as much as a year earlier. "Who does that benefit? Not Excite@Home," says Don Morgan, a managing director at MacKay Shields, one of the company's largest bondholders.



EX-CEO BELL: In April, he was still gunning "to go big"

"AT&T got control, and what did Excite@Home get?" AT&T's Petrillo says that the upstart did benefit: Instead of having all the cable partners pulling in different directions, the company would finally have guidance from one company: AT&T.

QUASHED. With AT&T firmly at the helm, Bell laid out a new strategy. On Apr. 20, the CEO said the company was "doubling down on its bet on broadband." After adding 350,000 new subscribers in the first quarter and hitting 1.5 million subscribers total, Excite@Home was going to accelerate its rollout—to about 500,000 subscribers per quarter—so that it could reach 3 million subscribers by yearend. "We are committed to go big," said Bell. Bell admitted that this would result in at least \$100 million in operating losses in 2000, vs. \$24 million in 1999. But Bell and Daniel E. Somers, who had replaced Hindery as head of AT&T's cable operations, assured investors they would have enough cash to pull off the more aggressive strategy.

As the days of 2000 rolled on, that assurance became increasingly suspect. Technology stocks continued to drop precipitously throughout the summer. That quashed Bell's plan to raise more money through initial public offerings of its foreign operations. The result: The company was steadily burning through its money. Its cash and short-term in-

vestments fell from \$502.3 million when Bell unveiled "doubling down" strategy \$200.8 million at the end of year. On Sept. 19, with company's stock at \$16, Bell announced he would resign CEO post as soon as a replacement could be found. He said he would stay on as chairman through the end of 2001, at least, helping to manage relationship with AT&T.

In January, 2001, the former duck CEO made one of the most controversial decisions of his tenure. He brought in Hoss Eslambolchi, a networking veteran at the long-distance company, to improve the quality of Excite@Home's service. AT&T and Bell both say that AT&T requested that Bell hire Eslambolchi as president of Excite@Home, but Bell agreed to hire him only on a temporary

basis. Eslambolchi improved Excite@Home's network—but at a tremendous cost. The company spent \$54 million on equipment and other improvements, 25% more than the year before, according to Securities & Exchange Commission filings. That contributed to a 48% drop in the company's cash and short-term investments, to \$104.5 million.

Excite@Home couldn't afford the kind of spending. On Apr. 17, Bell held a conference call with investors in which he admitted the company was in dire straits. It was going to miss its financial targets for the rest of the year and needed to raise \$75 million to \$80 million by June 30 to keep operating. AT&T's Petrillo says Eslambolchi's spending was necessary to boost the quality of Excite@Home's service. "Unless the quality improved, there was no argument to persuade Cox and Comcast to stay," says Petrillo and Bell say the key factor in the cash crunch was the steep drop in online advertising, which fell 41% in the first quarter to \$45.1 million.

That set the stage for the entrance of Patti Hart on Apr. 23. The former Sprint Corp. executive was supposed to start as CEO before the Apr. 17 announcement, but she got wind of the bad news and insisted Bell take the heat. She also asked for the chairman position, so that she would have enough

rol to make some drastic changes. was a sign of the deteriorating s at Excite@Home. In June, Cox Comcast gave six-month notice that would discontinue marketing te@Home service exclusively. Still, was able to raise twice as much ay as Bell had said was necessary in l. On June 11, the company received million from a group led by nethean Capital Group. Eight days ; the company got an additional \$85 on from AT&T by selling the long-ince company certain assets, which en leased back.

ven that cash wasn't enough. On 23, Hart told shell-shocked in-ors that the company needed still e money to survive the year. What ened? In an interview at the time, t explained that online ads had con- ed to plunge, that other companies ning to lease Excite@Home's office e had disappeared, and that suppli- were demanding cash up front. Dur- the next few weeks, Hart made sev- appeals to AT&T for more cash, rding to AT&T and others. On Sept. the company filed for Chapter 11 krruptcy protection.

DEBATS. That wasn't the end of the or. Once the company was in bank- tey, bondholders found out that one or contributing to the cash crunch that several cable companies weren't ing their bills to Excite@Home—be- se of quality issues, they said. The to- amount in arrears: about \$50 million. e liquidity problem was caused in ge part by the cable companies with- ling payments," says William P. Wein- ub, a lawyer at Pachulski, Stang, hl, Young & Jones who represents dholders. AT&T was up to date on its s, but Weintraub wonders why AT&T ces on Excite@Home's board didn't n on other cable players. "Our guys de phone calls," says Petrillo. "[But] management team had the responsi- ty to collect the money."

s AT&T responsible for the demise of eite@Home? Certainly, the company d only the upstart's best interests in d at the beginning. Armstrong, per- os more than anyone else involved, eved in the prospects for broadband ernet services. But at some point, mstrong and AT&T decided they were going to help Hart any more. Why? imately, AT&T, like Cox and Comcast, ided that broadband was too impor- t a business to leave in the hands of other company. "The business is so d that every cable company wants to in it," says Hearst. In the end, what led Excite@Home's fate was that it s the company that stood between cable companies and that goal.

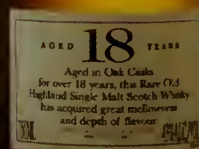
By Peter Elstrom in New York

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*(Aside from stashing
a few bottles aside.)*

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THE MUTUAL FUND MESS

Lousy returns, lumbering giant firms, too many funds—can the industry right itself?

Retired New York broker Marilyn Male is down in the dumps. Her investment in Baron Asset Fund has lost 17% this year. In three years, the \$3.4 billion fund has earned a measly 2.5%—less than she could have made in a plain-vanilla money-market account. Outside the New York Grand Hyatt's Empire State Ballroom, Male is in no mood to join the 2,000 shareholders boogying to a Motown band, wolfing down shrimp cocktail, and cheering patriotically as Liza Minnelli belts out *New York, New York* at Baron Funds' recent shindig. "'Am I concerned?' isn't a good question," she grumbles. "'Am I thinking about never buying another mutual fund again?' is a better one."

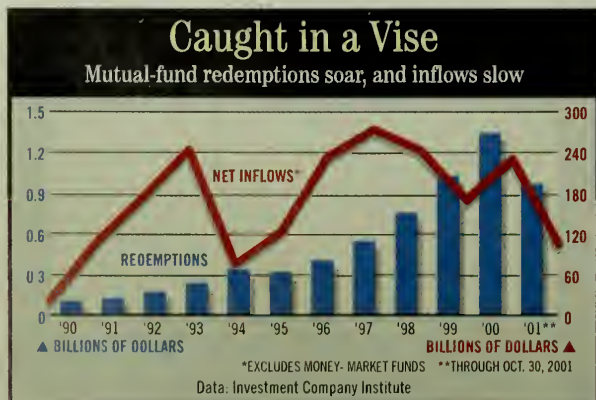
No doubt about it, America's long romance with mutual funds is on the rocks. The industry rode a decade-long bull market and a booming retirement business so well that it managed a record \$7.5 trillion of assets—nearly as much as Europe's annual gross national product—by the end of 2000. Since then, the industry has been in free fall. Assets have tumbled 12%, to \$6.6 trillion. The carnage in stock funds—the biggest money-spinners for management companies—is far bloodier: Assets have slumped 20% this year, to \$3.1 trillion, while net new sales are off by 95%. The 77-year-old industry has endured three of its biggest-ever one-month outflows from equity funds this year, a bigger cash drain than even in the 1987 stock market crash. More than half of all U.S. fund companies have seen more money head out the door than come in, says Boston's Financial Re-

search Corp. "Everybody's boat is sitting on the bottom right now," says Daniel T. Geraci, CEO of Boston's Pioneer Investment Management USA Inc. "The tide went out for all of us."

The mutual-fund industry is in a real mess. It's struggling with the huge burden of overcapacity it created by setting up thousands of new funds and hiring hundreds of high-priced managers to capture America's savings. With stock values crashing and investors deserting their funds, profits of the fund groups have collapsed under the weight of their outsize costs. Even more pain awaits, as a corps of smaller, low-cost funds with smart managers and decent returns starts to compete head-on with the behemoths.

FIZZLERS. Perhaps even more ominous is how the industry has damaged the very core of its business: investors' belief that the funds could produce superior returns at low cost while protecting them from untoward risk. Those investors still hanging on may be in for even more bad news as the funds scramble to cut costs. The coming wave of consolidation could throw many investors into mediocre funds with no clear mission. Many of the funds may raise fees and insist on big minimum investments to bolster their shrinking margins.

For years, the mantra of the industry has been "sell, so sell." Build a huge machine to muscle into every brokerage office and onto every household computer screen, the thinking went, and success would follow. Instead, the fund company credibility—and investors' trust—went out the door. In a rush to scoop up every last investment dollar in the 1990s, fund firms bombarded investors with nearly 6,000 funds, many of them mediocre. They pumped out funds specializing in sectors that quickly fizzled. Scores of now-defunct Internet ad-





ech funds hit the streets even as the bull market sputtered. ure, fund ads dutifully warned that prices could go down as well as up, but only winning funds are ever promoted. And unl the Securities & Exchange Commission clamped down, he companies routinely invented snazzy fund names to pique investors' interest, though stocks they invested in bore little relationship to the title or the risks of the fund.

All the hype created a situation in which the hopes and expectations of 93 million fund investors were bound to be dashed. Trouble is, mutual-fund managers and other investment pros such as pension-fund managers judge their performance

exclusively in relative terms—by measuring how well they do compared with a benchmark such as the Standard & Poor's 500-stock index. If the index is down 13%, as it is so far this year, they're heroes if they're only down 11%. That's phooey to most ordinary investors, who want to see their wealth expand in absolute terms and not simply get poorer slower than their neighbors. Even in this year's stock-pickers' market, more than half the managers are failing to beat their bogies.

TOXIC FUNDS? The few successful managers increasingly come from the hundreds of boutique firms running small funds most investors have never heard of. The \$46 million Aegis Value Fund, for instance, is up over 36% this year and has trounced both its peers and the S&P over the past three (page 103). Aegis and its ilk are starting to eat the behemoths' lunches. And increasingly, they're drawing business from institutional investors such as pension funds. For example, Strategic Investment Group (SIG) is placing \$40 million with entrepreneurial portfolio upstarts to manage on behalf of the \$151 billion California Public Employees' Retirement System, the world's second largest. SIG Chief Executive Hilda Ochoa-Brillembourg says big brand-name funds are a potential "toxic-waste site" for the baby boomers' retirement hopes. "All I see in their future

Special Report

is downside risk and very little upside potential," she says.

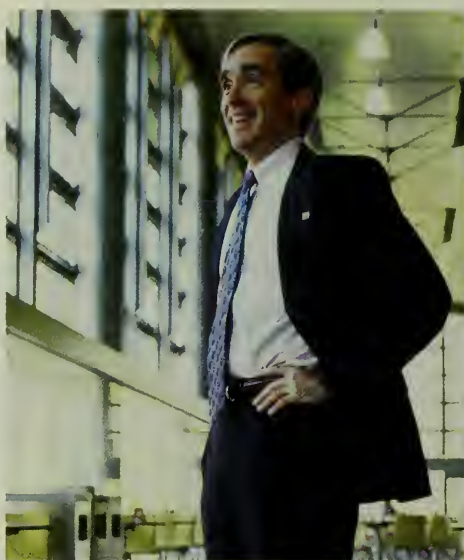
Twisting the knife in the wound, big fund companies are charging investors royally for lackluster results. They take \$1.54 in fees for every \$100 invested in equity funds, up nearly 14% since 1993, according to mutual-fund tracker Lipper Inc. Given that the costs of running funds don't rise much as assets grow, fees should be steady or even falling. To add insult to injury, some fund groups that have lost scads of money for investors are sticking them with extra charges—because the value of their accounts has sunk below the minimum investment. T. Rowe Price Associates, Dreyfus, Fidelity, and Zurich Scudder Investments impose such penalties. Others, including Franklin Resources, are even raising the minimum.

Apart from being stuck with those charges, some investors with big losses face steep tax bills—for capital gains on stocks bought months or years before they became shareholders.

Today, billion-dollar outfits are "questioning their survivability," says Steven E. Buller, Ernst & Young's national director for asset management. "Fund complexes large and small will rethink being in the investment-management business at all." The be-everything-to-everybody business model of giants such as Fidelity Investments, Dreyfus, Putnam Investments, and T. Rowe Price is showing serious chinks. However, most giant fund families are in denial. Richard A.

Spillane Jr., head of domestic equity at FMR Corp., parent of No. 1 Fidelity Investments, says investors get a "good deal at pretty reasonable fees with a lot of liquidity." He agrees that scale doesn't guarantee success, but it "improves your odds of delivering the performance," he says. "It allows us to have a 500-person equity staff spread all over the globe. It allows us to have arguably the best trading department on Wall Street." Yet few of Fidelity's investors are likely to be as sanguine as Spillane: A third of Fidelity's U.S. diversified equity funds are lagging their peer group this year and for the past three years, according to fund researcher Morningstar.

"COMPLACENCY." Indeed, few companies have faced up to the new reality by cutting staff, trimming offerings, or nixing expansion plans. Many fund execs still earn more than Wall Street tycoons: Mario J. Gabelli of Gabelli Asset Management Inc. raked in \$45.5 million in 2000, while Lawrence J. Lasser at Marsh & McLennan's Putnam Funds pulled in \$35.2 million, including options and other cash payouts. The median portfolio manager will earn about \$436,500 this year, 35% more than in 1999, according to



headhunter Russell Reynolds Associates. In fact, expenses will grow faster than revenues for the third

VANGUARD AT THE FOREFRONT

Brennan's firm has kept costs low while developing products to fend off rivals. Result: It's taking in billions more this year

machines and rather indifferent managers. Their best hope may be to buy portfolio management from specialists to boost their sickly performance, as American Express Co. recently when it hired Mario Gabelli of Pilgrim Baxter & Associates, Wellington Management to run a series of new funds. But they'll have to restore confidence. That means, for example, closing large funds before the volume of new assets swarms performance. And if a fund fails, it will need to return money to investors rather than merge the fund into something remotely similar, just to keep

the account. Some outfits have gotten the message already. When it liquidated its \$500 million Longleaf Partners Real Estate Fund in November, Longleaf Partners gave back what it had taken from investors, saying the shrinking market in real estate stocks was too small to make profits.

Investors aren't just fleeing weak markets and poor performance—they're searching for sophisticated, custom-fit investments. Mercer Manager Advisory Service reports that \$9.3 billion went into competing alternative investments such as hedge funds and private-equity partnerships in the first half of 2001, up from \$4.8 billion in the first half of 2000. "Investors are so disappointed with performance that they're thinking, 'By God, if I'm going to spend money in this environment, I want smarter managers,'" says John Markham, president of the 170,000-member American Association of Individual Investors in Chicago. "I don't know that the mutual-fund industry can deliver."

The mutual-fund giants had better learn fast if they're to tap the fastest-growing, most lucrative slice of the U.S. population: people with \$5 million or more to invest. Already there are 400,000 of these affluent households, and Goldman Sachs & Co. figures that number will grow 18% a year

Special Report

THE MUTUAL-FUND MESS

straight year as a result of hefty paychecks: Employee expenses account for 70% of operating outlays, says Capital Resource Advisors, a Chicago financial-services consultant. Overall operating margins, while still a heady 35%, are 16% less than two years ago. "Most big fund companies are hurting. Their talent is leaving. Combine that with complacency, and we're in for a remarkable transition like we've never seen before," says Christopher J. Acito, managing director of financial services for Barra Strategic Consulting Group.

What's in store? Monolithic, one-stop fund companies must come to terms with what they've become: huge marketing

Big Fund Groups Are Struggling

Average returns of stock funds run by the nation's largest fund families

	TOTAL NET ASSETS BILLIONS	2001 TOTAL RETURN*	NUMBER OF FUNDS
FIDELITY INVESTMENTS	\$454.0	-12.1%	291
VANGUARD	344.9	-9.5	78
AMERICAN FUNDS	296.6	-6.3	32
PUTNAM INVESTMENT	138.6	-18.9	167
JANUS	101.7	-22.6	26
FRANKLIN TEMPLETON	86.0	-9.5	156
T. ROWE PRICE	69.6	-10.8	58
AIM	69.3	-20.9	127
MFS	64.5	-18.6	147
AMERICAN CENTURY	60.0	-9.8	69
OPPENHEIMERFUNDS	52.3	-13.0	121

	TOTAL NET ASSETS BILLIONS	2001 TOTAL RETURN*	NUMBER OF FUNDS
AMERICAN EXPRESS	49.7	-18.3	97
MORGAN STANLEY	40.9	-17.3	176
MERRILL LYNCH	38.9	-14.7	126
ALLIANCE CAPITAL	38.4	-16.5	95
ZURICH SCUDDER	35.3	-16.7	142
STATE STREET	35.3	-13.5	34
VAN KAMPEN	32.1	-17.6	88
SMITH BARNEY	32.0	-13.6	117
DREYFUS	28.5	-12.3	143
S&P 500-STOCK INDEX		-13.7	

*Through Nov. 30, 2001

Data: Lipper Inc.



A SHIPMENT OF PLASTIC IS MISSING IN THAILAND. SO A FACTORY STOPS WORK IN PARIS.

AND A CEO GOES SLEEPLESS IN CINCINNATI.)

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through 2004. Financial Research adds that over the next three to five years, as much as 50% of the \$1 trillion in mutual-fund assets owned by the affluent will switch to so-called separate accounts. These custom-made products invest in individual stocks and some pure-play sector funds and charge a fee based on the assets. They offer what mutual funds do not: more transparency and tax-efficiency.

If they're not careful, mutual funds could start to lose their stickiest assets—401(k) retirement funds. With Americans aging and changing jobs more often, rollovers are forecast to explode. It's not unusual for such accounts to reach \$1 million now—and to head to banks or brokerages' individual retirement accounts, siphoning assets from fund firms. In 1999, the \$2.5 trillion IRA marketplace, in which the fund industry lacks servicing skills, surpassed 401(k) assets for the first time. "It's a potential minefield," adds Consultant Kurt Cerulli of Boston's Cerulli Associates Inc. "It's a market more about advice and guidance. Fund dollars are starting to shift."

CATCH-UP. And fund companies are out of the loop: The top five New York brokerages—Salomon Smith Barney, Merrill Lynch, Morgan Stanley Dean Witter, Prudential Securities, and UBS PaineWebber—collect 70% of the \$275 billion separate-account business. Even though fund firms manage many of the underlying portfolios, brokerages capture the lion's share of management fees. With the market forecast to triple, to \$730 billion, by the end of 2005, fund companies are playing catch-up with strategic acquisitions. This year, Eaton Vance acquired Fox Asset Management, while Legg Mason bought Private Capital Management in Naples, Fla., to gain a toehold in the high-net-worth market.

Others are moving fast to get into hedge funds, which pulled in a record \$22.3 billion in the first three

quarters of 2001, vs. \$8 billion last year. Immediately after his appointment in July, John V. Murphy, CEO of \$115 billion OppenheimerFunds Inc., which earns 95% of revenues from mutual funds, bought Tremont Advisors Inc., manager of \$8 billion in hedge-fund accounts. Two new funds, with \$50,000 minimums, will be launched in January for high-net-worth investors. "We want to grow faster than what the mutual-fund business is going to give us," says Murphy.

Of course, not every firm needs to be an upmarket distributor. There's still room for the low-cost provider, such as Vanguard Group whose 52 equity funds have expenses averaging 0.32%, vs. over 1.5% for the industry. Through September, Vanguard has collected some \$26.2 billion of net new money, almost double the \$14.3 billion in the same period last year. "Our business has been quite robust since the silliness on the stock market ended in April of last year," says CEO John J. Brennan. Still, Vanguard isn't resting on its laurels. When the Malvern (Pa.) company was threatened by exchange-traded funds (an alternative to mutual funds that trade like stocks on an exchange), it developed its own ETF product line, including the Vanguard Total Stock Market VIPERS, which tracks the broad Wilshire 5000 index. To hold on to the \$700 billion it has under management already, it is developing a private-equity investment program for wealthy clients and rewarding long-term investors with charges as low as 0.12% of assets.

Few fund companies could live with such low fees. But they don't have to. Their best hope of restoring their fortunes is to brace for a decade of slower growth in which enriching their clients should be top priority. Their worst tactic would be to sit back and wait for the markets to recover—and the money to start rolling in again. It may well not.

*By Mara Der Hovanesian,
with Lewis Braham, in New York*

SMALL V

Funds so diminutive that newspapers don't list them are outperforming the big boys

Some of the best mutual funds aren't found in the obvious places. They don't grace the daily fund listings of major newspapers. They're not offered in most retirement plans. Their logos aren't emblazoned on coffee mugs or billboards. They don't create funds marketing gimmicks—in fact, they barely have marketing budgets. They're tight-knit, often family-run partnerships that invest their wealth alongside their clients. And they off



MELLODY HOBSON

32, President, Ariel Capital Management Inc.,
Ariel Mutual Funds, Chicago, Illinois

FOUNDED 1983 by Chairman and CEO John W. Rogers

ASSETS \$6.5 billion; \$1.3 billion in two no-load equity

YEAR-TO-DATE RETURNS Ariel Fund, 9.19%, vs. 10.9%
peer group; Ariel Appreciation, 12.73%, vs. 6.53%

INVESTMENT STYLE Deep value, small- and medium-size com

NDERS

ke their mark with stocks that Wall Street shuns. Tiny companies such as Allied Research Corp., maker of electronic security products, or sportswear manufacturer Lita Apparel Inc. aren't the sort to be featured in megafunds, but they get top billing in the likes of the \$46 million Capital Value Fund. Launched without fanfare in 1998 by Arlington (Va.) investment managers Berno, Gambal & Barbee Inc., it is the firm's only fund. "It allowed us to show the world what we can do, even if we don't have that million-dollar marketing smile," says fund manager Scott L. Barbee. Named for the shield of Zeus, father of the gods in Greek mythology, the fund has delivered 20% annual gains over the past three years, handily beating not only its peer group of 18 percentage points but also the Standard & Poor's 500-stock index' 18% gain. A nifty return of 37% through Dec. 4—the result of investing in stocks that trade below their liqui-

dation values—catapulted it into the top 10 of all funds. "A lot of managers focused on beating the indexes in the short term, even if it meant destroying their clients' accounts with high-priced stocks," says Barbee. "They've got very significant egg on their face, and they deserve it."

This is the year of the boutique manager. The industry's stars look a lot like Boston Partners Asset Management LP, whose Small Cap Value Fund is up 53% in the 12 months ended Dec. 4. Its second fund—the Boston Partners Long/Short Equity Fund, is up 35%. Both are just three years old. Other newcomers such as the CGM Trust Focus Fund and Ameristock Focused Value are up 40% and 53%, respectively, this year. But don't get the wrong idea: Pumping out a few years of scorching returns doesn't cut it. Plenty of fly-by-night entrepreneurs crashed and burned at the end of the roaring '90s. The successful managers are steady hands

who've been in the business for years. They're Turner Investment Partners Inc. in Berwyn, Pa., or Salt Lake City's Wasatch Advisors Inc.—experienced managers of old money before they launched funds. "There has never been a better time to manage a small or mid-size fund," says Christopher J. Acito, managing director for Barra Strategic Consulting Group.

Not so long ago, such funds were put on the endangered-species list by Goldman, Sachs & Co. In a 1995 report, *The Coming Evolution of the Investment Management Industry*, it figured that a mutual-fund family needed to manage at least \$150 billion of assets to survive. Today, the venerable bank is singing a different tune. "These small, regional firms are usually very, very profitable, and they are not under any tremendous pressure to get bigger to survive. This is a business driven by performance," says Managing Director Donald J. Truesdale.

PICKY PEOPLE. Performance is what they deliver. Today, more than 1,350 independent firms manage about \$100 million each, according to researcher Nelson Information, a unit of Thomson Financial. And they are the *crème de la crème* of stock-pickers—sought after not only by the well-heeled but increasingly by big-time institutional clients. Even the big mutual-fund families are scrambling to hire them. Large-cap specialist Marilyn Holt-Smith and her partner Kristin Yates of Madison (Wis.)-based Holt-Smith & Yates Advisors have been deluged with business. "It's been wild," says Holt-Smith. "We are being asked to make our pitch in three different parts of the country on the same day." An annualized 18.74% 10-year return makes it No. 4 in the field of large-cap growth managers, ahead of far larger competitors such as Janus, Invesco, and Dresdner RCM, according to *Money Manager Review* in San Francisco.

The independents are surging thanks to the Internet and a budding corps of financial planners called registered investment advisers (RIAs). The Internet fostered mutual-fund supermarkets—no-fee, Web-based shops such as

A. CORBIN

Portfolio manager

& Co.,

with

ED 1992

\$80 million,
g \$5 million in
oad Corbin
ap Value Fund

O-DATE

WS 48.13%, vs.
for peer group

MENT STYLE

and medium
market caps below
on



MARILYN HOLT-SMITH, KRISTIN YATES (left)

Respectively 48 and 42, both portfolio managers and owners at Holt-Smith & Yates Advisors, Madison, Wis.

FOUNDED 1987

ASSETS \$750 million firmwide. New sub-advisers for \$100 million no-load Managers Funds-Capital Appreciation Fund

YEAR-TO-DATE RETURNS 18.74% 10-year return, vs. the 9.62% gain in the Dow Jones Large-Cap Growth Index

INVESTMENT STYLE Concentrated, large-cap growth stocks with market caps of \$2 billion and up



Market uncertainty is leading investors to financial planners, who often direct them to small but solid funds

Charles Schwab & Co.'s OneSource and TD Waterhouse Group Inc.'s FundSmart OneStop—that allowed investors to shop among thousands of funds without paying steep brokerage fees and gave small funds a chance over the years to reach a huge new audience. “The industry became more of a meritocracy,” says Kurt Cerulli of Boston's Cerulli Associates Inc.

Now, as nest eggs shrink and anxieties about the markets

swell, do-it-yourselfers are keener than ever on professional help. That's where the advisers come in. The

Special Report

THE MUTUAL-FUND MESS

Internet is their low-cost back office, objectivity their selling tool. Rather than collect commissions on each sale, they charge a percentage of investors' assets as an annual fee. They don't have to peddle any parent company's products: Their only incentive is to increase clients' net worth—and that boils down to buying low-cost funds with standout performance. They take the time to find small up-and-comers that can make an outside contribution to returns. So important is their link to investors these days that Fidelity Investments, Montgomery Asset Management, and others are falling over themselves to woo RIAs with free seminars, software, and other perks.

“SMALL IS AN ASSET.” Even so, some tip-top funds are still off the radar screen. Consider Mosaic Mutual Funds of Milwaukee. Schwab's Mutual Fund Select List won't list the diversified fund since it has less than \$50 million in assets, nor will major newspapers, which have all raised their cutoff points this year. But a handful of loyalists know of the \$30 million Mosaic Equity Investors Fund's enviable record: a 14% annualized return since its inception 23 years ago. Advisers can easily raise fund managers on the phone at Mosaic. “Small is an asset when it comes to communication,” says Larry Tabak, vice-president of Madison Investment Advisors Inc., which manages Mosaic Funds. “Some planners may be influenced by the traditional schmoozing and lunches, but most want to work with a firm that doesn't have so many layers of bureaucracy.”

Such small funds are eco-

nomically viable thanks to information technology and ease of outsourcing administrative tasks such as shareholder communications and quarterly statements. A decade ago it cost upwards of \$100,000 to launch a mutual fund; today it can run as little as \$10,000. Now, a fund with only \$4 million to \$8 million in assets can be profitable, vs. about \$1 million in the mid-1990s, says Kenneth D. Trumpfheller, president of Unified Fund Services of Indianapolis, an administrator for 31 independent fund groups. “All these funds have to do is raise and manage the money, which is what they want to do anyway,” he says.

DIFFERENT DRUMMERS. The boutiques with the best returns specialize in investment niches. “We're purists,” says Mello Hobson, president of Chicago's Ariel Capital Management Inc., which favors value investing. In large part, it markets to African American investors. Seattle's Progressive Investment Management Corp. buys companies that are socially and environmentally conscious, a segment that's grown assets 36% since 1999, far ahead of the industry's overall growth. The \$5 million Corbin Small-Cap Value Fund, up 48% this

year, buys tiny, fast-growing companies such as Forge and Titan Corp. “We don't have to own the third-party car company or Microsoft,” says David A. Corbin, who launched his only mutual fund four years ago as a sideline to his money-management business. The fund is ranked No. 5 among equity funds this year.

What Corbin and his peers have in common may be the real clincher of success in investment management—entrepreneurial spirit. William G. Lowery, Chicago's Performance Analytics Inc., a consultant with \$10 billion in pension and endowment assets, picks managers with “heart and conviction about their work, especially at the early stages of their success.” His discoveries include Horne Smith & Yates and Wolfgang Asset Management in Sarasota, Fla. In 1991, he gave Richard H. Driehaus, Driehaus Capital Management Inc., four of his five first clients. Driehaus, an international stock manager in Chicago, today manages \$3 billion. “You need a new name who's very hungry,” says Lowery. “Otherwise you set yourself up for mediocrity.”

By Mara Der Hovanesian
in New York

Small Funds, Big Returns

Top-performing funds with \$100 million or less, run by companies with up to \$1 billion under management

FUND	INCEPTION DATE	3-YEAR TOTAL RETURN*	RANK	AVERAGE RETURN OF PEERS*
QUAKER INV. AGGR. GROWTH A	1996	32.5%	1	2.8%
BRIDGEWAY MICRO-CAP	1998	31.7	2	10.9
PERKINS DISCOVERY	1998	29.4	3	10.9
RESERVE SMALL CAP GROWTH R	1994	27.0	4	7.6
AL FRANK FUND	1998	27.0	5	9.5
TOUCHSTONE EMG. GROWTH A	1994	26.2	6	10.1
ROCKLAND SMALL CAP GROWTH	1996	24.9	7	10.1
BRIDGEWAY ULTRA-SMALL CO.	1994	24.6	8	10.2
SCHNEIDER SMALL CAP VALUE	1998	24.5	9	10.2
DRIEHAUS ASIA PAC. GROWTH	1997	22.7	10	-1.0
SANTA BARBARA BENDER A	1998	22.4	11	1.7
HERITAGE MID CAP STOCK A	1997	22.2	12	10.8
FORUM FOUNTAINHEAD SP. VALUE	1996	21.8	13	10.1
SG COWEN OPPORTUNITY A	1988	21.5	14	10.9
NEVIS FUND	1998	21.0	15	7.6
IMPACT TOTAL RETURN	1997	20.8	16	2.8
TOCQUEVILLE SMALL CAP	1994	20.0	17	10.2
FPA PERENNIAL	1984	20.0	18	10.2
AEGIS VALUE	1998	19.9	19	10.2
GREEN CENTURY BALANCED	1992	18.7	20	3.6

*Annualized total return through Nov. 30, 2001. Excludes single-country and sector funds, multiple share classes, and institutional funds

Data: Lipper Inc.

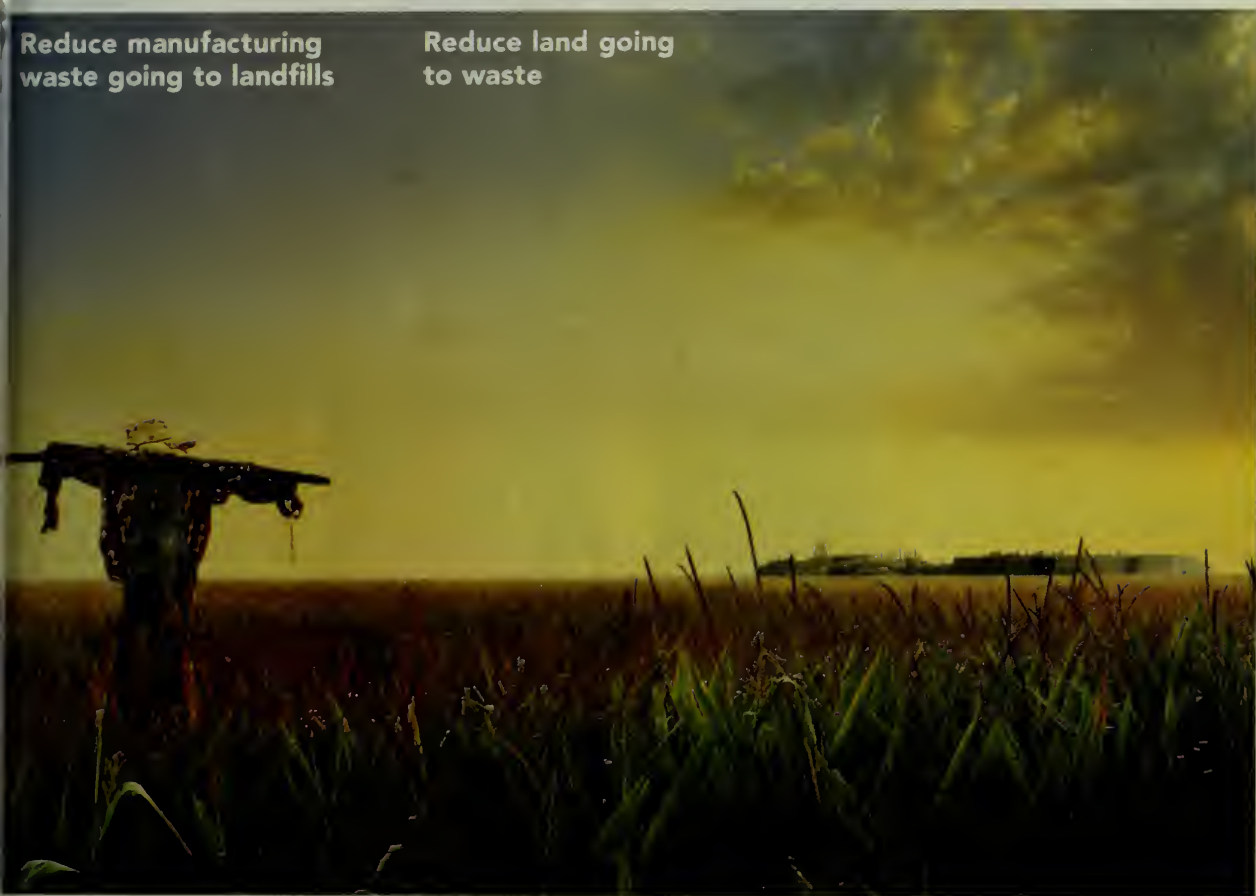
TODAY

Reduce manufacturing
waste going to landfills

TOMORROW

Reduce land going
to waste

TOYOTA



Each year Toyota builds more than one million vehicles in North America. This means that we use a lot of resources — steel, aluminum, and plastics, for instance. But at Toyota, large scale manufacturing doesn't mean large scale waste.

In 1992 we introduced our Global Earth Charter to promote environmental responsibility throughout our operations. And in North America it is already reaping significant benefits. We recycle 376 million pounds of steel annually, and aggressive recycling programs keep 18 million pounds of other scrap materials from landfills.

Of course, no one ever said that looking after the Earth's resources is easy. But as we continue to strive for greener ways to do business, there's one thing we're definitely not wasting. And that's time.

www.toyota.com/tomorrow

COMMENTARY

By Paul Raeburn

MENTAL HEALTH: BETTER BENEFITS WON'T BREAK THE BANK

More than 80% of American employees and their families face tougher limits on coverage for mental illness than they do for other health conditions. That's a serious problem for the one in five Americans who, according to the U.S. Surgeon General, will suffer from a mental disorder in the course of a year. Advocates for the mentally ill have pushed hard for parity in the coverage of mental illness and other ailments. But opponents have warned that parity could provoke a disastrous surge in health-care costs.

A 1996 federal law that went partway toward establishing parity has done little to improve coverage. But on Dec. 3, House and Senate conferees began meeting to decide the fate of a Senate amendment—passed by voice vote—that would establish full parity. (The House did not pass a similar amendment.)

Opponents are again warning about costs, but new data and several independent studies suggest that employers' costs for mental-health parity could be very small—amounting to less than a 1% increase in health care costs. In 1996, several studies by the government and lobbyists had estimated that the expansion of mental-health benefits could add as much as 10% to health-care costs. But those studies were done before it was shown that managed care was very effective in controlling mental-health expenses. **"NO DISASTER."** One of the new studies was done by The RAND Corp. Based on an examination of 24 managed-care mental-health plans covering 140,000 people, the study concluded that the added cost of providing mental-health coverage equivalent to other medical coverage would come to less than 1%. The RAND researchers also looked at mental-health care costs in Ohio, which instituted equal cover-

age a decade ago. "Their costs are totally stable—there is no big increase, no disaster," says Roland Sturm, an economist and the study's author.

Another estimate came from the Congressional Budget Office, which reviewed the Senate bill. It concluded that complying with the bill would cost the private sector about \$3 billion in 2002, rising to \$5 billion or slightly more in 2006. Those numbers are only a tiny fraction of the

Flynn III, OPM's associate director for retirement and insurance, told Congress last summer.

Even some opponents of mental-health parity legislation agree the costs are much lower than originally thought. Kristin Apgar of The Washington Business Group on Health, which represents large employers, says the group's members oppose mental-health parity legislation because "they don't think Congress

should determine what their health-benefits package should look like." But many members offer generous mental-health benefits, and they have found that the costs are low.

One of the fiercest opponent of mental-health parity is the ERISA Industry Committee, a group of large employers, mostly in manufacturing. The organization argues that the Senate amendment would encourage excessive government interference. "This is microeconomic parity, parity down to a much more detailed level," says Anthony Knettel, vice-president of the group. Some firms, he says, might simply drop mental health coverage, which the Senate amendment allows.

Traditional insurers and HMOs also oppose mental-health parity—but patient organizations and the HMOs that administer mental-health benefits support it. "Finally people are understanding that mental illness is an illness like other illnesses," says Pamela Greenberg, executive director of the American Managed Behavioral Healthcare Assn.

The demand for better mental-health coverage is growing. Many companies have already chosen to offer their workers expanded mental-health benefits, without waiting for the government to order them to. Other employers—eager to avoid government mandates—may decide to do the same.

Raeburn writes about science and medicine in New York.

MENTAL ILLNESS IN THE U.S.



- ▶ About one in five Americans will suffer from a mental disorder in the course of a year
- ▶ Approximately 18.8 million American adults suffer from depression
- ▶ Treatment costs run about \$80 billion a year
- ▶ Mental illness causes more disability and loss of life than any other illness except heart disease
- ▶ The cost of the resulting loss in productivity is estimated at \$80 billion per year
- ▶ Cost-effective treatments now exist for many forms of mental illness

Data: U.S. Surgeon General

\$1.2 trillion the U.S. now spends on health care annually.

These estimates are backed up by real-world experience. Mental-health parity was extended to 2.2 million federal employees and their families on Jan. 1. The federal Office of Personnel Management (OPM) reports that premiums have increased 1.3%. "Our goal of expanding access to mental-health benefits in an affordable way was achieved," William E.

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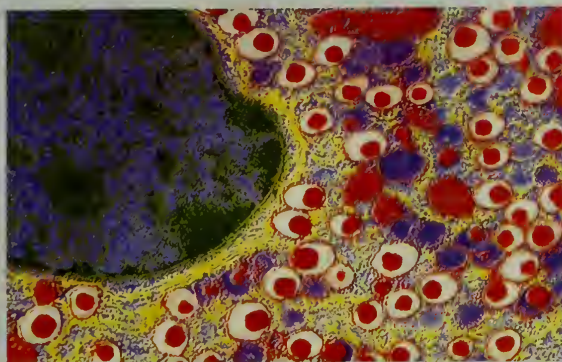
THE CHIP WAR MOVES TO TERAHERTZ TERRAIN

TYPICALLY, THE ANNUAL International Electron Devices Meeting (IEDM) provides glimpses of new chip technologies that will pump up the electronics industry over the next several years. At this year's early December gathering in Washington, it was clear that the rivalry between Advanced Micro Devices and Intel remains a technology driver that's not about to let up.

Both AMD and Intel unveiled designs for future transistors a mere 15 nanometers wide at the internal switch, the "gate." STMicroelectronics is as close a runner-up, at 16 nm. That's less than a fourth the size of the smallest transistors now produced. These teeny critters should dominate the market around 2009. Intel's microprocessors contain more than a billion transistors—a twentyfold increase—and switch at terahertz speeds, or trillions of times a second. Intel grabbed headlines last month by claiming its 15-nm transistor could switch at a record 2.6 THz. But AMD boasted at IEDM that its version can hit 3.3 THz, or 30 times faster than today's fastest devices.

How much faster can transistors go? A lot, according to IBM: not just a few terahertz, but perhaps as much as 30 THz. Researchers predict that by around 2016, switches will shrivel to 9 nm, then hit physical limits. Beyond that, transistors can get no smaller, because they will contain only about 30 silicon atoms. But at IEDM, Big Blue unveiled a concept that it believes may circumvent that limit: transistors that have stacked gates. These may go on racking up higher speeds into the 2020s. □

A NEW WAY TO ATTACK TYPE 1 DIABETES



A DRUG DEVELOPED AT THE WEIZMANN INSTITUTE OF Science may open paths to treating Type 1 diabetes. About 15% of diabetics suffer from this condition, which typically reduces life expectancy by 15 years. Reporting in the Nov. 24 issue of *Lancet*, researchers at Weizmann and Jerusalem's Hadassah Hospital say that in clinical tests, the new drug, called DiaPep277, arrested the progression of diabetes by stopping the immune system from destroying insulin-producing pancreatic cells (picture).

Dr. Felix Mor, an immune-system expert at Rabin Medical Center near Tel Aviv, terms the findings "very important," especially because in early trials, the drug seems to prevent the disease in healthy people genetically disposed to get it. It's the first drug to mitigate the immune system's attack on pancreatic cells, claims Peptor, the Rehovot company with marketing rights for the drug. After a final trial next year, it plans to apply for Food & Drug Administration approval in 2004.

Neal Sandler

HUNTING GENES IN ICELAND TO FIGHT ARTHRITIS

A BIOTECH COMPANY THAT'S using the population of Iceland as its research lab has found a gene linked to rheumatoid arthritis (RA), a chronic autoimmune disease of the joints. It is the fourth such announcement since September by deCODE Genetics Inc. in Reykjavik, which holds exclusive rights to a medical database of almost all the citizens of Iceland. Earlier, it reported mapping genes associated with obesity, anxiety, and Parkinson's disease.

Iceland is something of a genetic mother lode, boasting probably the world's most homogeneous populations. Most

residents can trace their ancestors back to Vikings who settled the country 1,000 years ago. In 1999, Iceland licensed its medical records to deCODE for 12 years.

To find the RA gene, deCODE first screened some 2,500 Icelanders from about 100 families for variations in a group of immune-system genes already known to increase the risk of developing RA. Researchers then scanned the whole genome of those Icelanders with the disease and found another gene on chromosome 3 closely linked to RA. deCODE CEO and founder Kari Stefansson says that an individual with both related genes has a 40% greater chance of developing RA than those without either gene.

Catherine Arnst

INNOVATIONS

■ Despite mounting evidence that the oceans' fish stocks are shrinking to perilous levels, the U.N. Food & Agriculture Organization (FAO) reported steady increases in fish catches during the 1990s. The FAO data were wrong. China's reports to the agency were grossly inflated by officials whose promotions were, until recently, based on the size of China's catch—which is dropping, not growing. The discrepancy was uncovered by researchers at the University of British Columbia.

■ Blasting cancer with sound waves may soon be a safer, cheaper alternative to surgery. In clinical trials at University Hospitals of Cleveland and Case Western Reserve University, radio-frequency energy delivered through a needle inserted into a tumor cooked it to death. The technique killed the tumors in 10 of 11 patients. A similar treatment for prostate cancer has been developed by Focus Surgery in Indianapolis.



■ Spread by mosquitoes, malaria kills millions of people each year. This deadly scourge might be stopped if scientists could pinpoint the precise combinations of chemicals that attract the insects. A team led by biologist Laurence J. Zwiebel at Vanderbilt University has taken a step in that direction, isolating key genes that govern how mosquitoes sniff out their victims. That understanding should lead to better repellents—or irresistible lures for lethal traps.

CHRYSLER'S WINK-WINK, NUDGE-NUDGE CAMPAIGN

So far, its risqué new TV ads aren't adding up to car sales

When James C. Schroer jumped ship from Ford Motor Co. earlier this year to become Chrysler Group's executive vice-president for global sales and marketing, he vowed to pump new life into the auto maker's tired Chrysler, Dodge, and Jeep brands. His strategy called for provocative ads and innovative buzz marketing, the same approach he used at Ford to build youthful demand for the new Focus compact. Now, after seven months of work, Schroer and his team—many brought over from Ford—are showing the first fruits of their labors.

And provocative they are. In one commercial, which Chrysler later toned down after receiving complaints, a 12-year-old girl was horrified to learn her baby sister was conceived in the back seat of the family's Chrysler Concorde sedan. In another, a leering suburbanite asks his neighbor if he's into "swapping"—minivans, that is, not wives. In a third ad, a young man bounces suggestively in the backseat of a Dodge Neon—to test its suitability for a large dog. Schroer also inked an unusual product placement with Activision Inc. Now, Tony Hawk's Pro Skater 3, Activision's new video game that's popular with twentysomething guys, is chockablock with images of the Jeep Wrangler and Liberty.

HANGOVER CURE. Whether those efforts amount to the rethinking of car advertising that Schroer promised—or are just a weak attempt to get noticed by any means—is generating debate in marketing circles. More important for Chrysler, however, is whether any advertising, provocative or otherwise, matters when consumers are riveted mainly by offers of interest-free loans and hefty rebates. Schroer is attempting long-term brand

building while the rest of the industry frantically trades profits for market share. "It's tempting to chase the share and the deal targets, but it's a terrible hangover you face when you come off of that," in brand image, used-car values, and profits, explains Gary Dilts, Chrysler's senior vice-president for sales.



SCREEN GEMS?

Suburban guys consider "swapping"—minivans (top); Jeeps in a video game



So are risqué TV messages helping to sell vehicles? Not so far. Chrysler's

problem is that its spicy new ads are being drowned out by the din from rivals offering free financing in the wake of the September 11 attacks. After lowering sticker prices on many vehicles in early September in a bid to wean customers off profit-sapping incentives, Chrysler was reluctant to follow General Motors Corp. and Ford into 0% financing. Even after it joined the fray, it didn't offer the financing deals on its most popular models, the PT Cruiser and

Jeep Liberty. It added an extended warranty offer in an attempt to draw attention from others' cheap deals.

The ploy doesn't seem to be working. Chrysler is missing the boom in SUV auto sales. In November, while GM and Ford enjoyed sales gains of 13% and 4%, Chrysler's sales fell 6%. Chrysler says its retail sales were actually up a couple of points, but that its overall market share was hurt by lower retail sales. Still, its 13% market share is 2 points below the level of a year ago. Chrysler dealers say the seven-year, 100,000-mile warranty has helped to close deals with customers already in the showroom but has done little to draw new traffic. Many dealers, though, seem willing to give Schroer a chance. "Dealers like instant gratification,"

admits Ron Jelling, who owns a Chrysler dealership in Paramus, N.J. "But [Chrysler's] philosophy is to get more brand recognition in a long-term campaign."

BAD TIMING. Adding to Chrysler's marketing woes, the launch of its much-anticipated 2002 Dodge Ram—the truck that Dieter Zetsche calls one of the three pillars of the company, along with minivans and the Jeep Grand Cherokee—was interrupted by nonstop news coverage of the terrorist attacks. By the time the Ram's "Get Life by the Horns" campaign resumed, featuring Aerosmith, the truck was smack in the middle of a pickup price war between GM and Ford. "When the big guys are screaming at each other, you can't make your voice heard," says analyst John Case.

of Merrill Lynch & Co. Indeed, the restyled Ram is off to a slow start. The predicament leaves Chrysler, already in deep financial trouble, with few options. It can't afford to keep offering steep discounts on its cars and trucks. But if its market share slides any further, its entire three-year, \$3.9 billion turnaround plan could collapse. "We are trying to walk a tightrope here between market share and earnings," says Schroer. As long as that's the case, Schroer's marketing gambits will remain just so much background noise.

By Joann Muller
in Auburn Hills, Mich.

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Dec. 13-16
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Dartmouth College
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Maeres Opera House
University of Houston
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DeSalles Theatre
Convent of the Visitation
Schaal
Mendota Heights
612-343-3390

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Dec. 7-9, 14-16
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Nov. 30, Dec. 1-2, 7-9
8 Performances
Scottish Rite Theatre
503-224-7411

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6 Performances
Riotta Theatre
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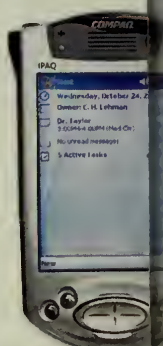
EDITED BY LARRY ARMSTRONG | A hot car that's retro. A bike that's definitely not. Cameras with disks and docks, and a wrinkle-free way to pack frocks. From Altima to Xbox, there's something for everyone in *BusinessWeek's* list of the year's best ideas. So put a little music in your pocket, and settle back. We'll show you a paper towel we found as we mopped up the crème de la crème.

BEHEMOTH
Pundits like to say it took Microsoft three tries to get it right. Pocket PC 2002 is Microsoft's fourth try at making a handheld operating system for handheld computers—and it's a winner. While products based on Palm software still dominate, Pocket PCs such as the ► Compaq iPAQ 3800 and the ► HP Jornada 565 have a growing appeal to high-end buyers (pocketpc.com).



POCKET-SIZE BEHEMOTH

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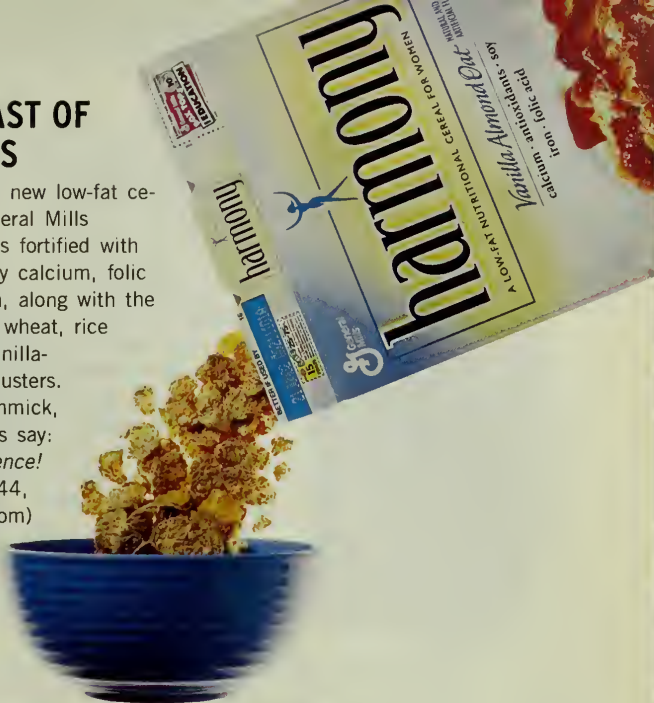


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▲ "Payroll cards" let folks with no bank account have their paychecks deposited into a Visa account. Pioneered by Visa member bank First Tennessee Bank, they save check-cashing fees and work like debit cards in ATMs and stores (800 611-6263, www.ftb.com/paycard).

BREAKFAST OF HEROINES

► Harmony, a new low-fat cereal from General Mills (\$3.69) comes fortified with femme-friendly calcium, folic acid, and iron, along with the usual toasted wheat, rice flakes, and vanilla-almond oat clusters. Critics cry gimmick, but consumers say: *Vive la différence!* (800 328-1144, generalmills.com)



A PORTABLE WITH POLISH

◀ The best thing you can say about the aesthetics of most computers is that they are inoffensive. Not so the Apple PowerBook G4 laptop: Clad in a striking titanium case, it's a beauty. The PowerBook, which starts at \$2,199, is highly functional, too, with an unusually wide 15-inch display that sets a new standard for portables (800 692-7753, powerbook.com).



(CLOCKWISE FROM TOP RIGHT) PHOTOGRAPHS BY TED MORRISON (HARMONY); COURTESY OF APPLE COMPUTERS (LAPTOP)



HANDHELD CHIC

◀ The Samsung I300, \$499 from Sprint PCS, combines the functions of a wireless phone with those of an up-scale Palm organizer. No keypad here. Dial by speaking a name or number or by tapping the screen (800 726-7864, samsungusa.com).

XBOX HITS THE BULL'S-EYE

▼ Microsoft's \$299 Xbox packs a wallop in the high-stakes video game shootout. It's a serious gamer's dream with cutting-edge graphics, hard-disk, and DVD player. Extra-cost add-ons are a turnoff, though (800 469-9269, xbox.com).



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GOT TO GO 'EM CREDIT

▲ Ever check your credit report for accuracy? With Credit Watch (\$49.95/year), credit bureau Equifax monitors your report nightly and e-mails you if there has been an unauthorized change. That way, you'll know when something's amiss (equifax.com).

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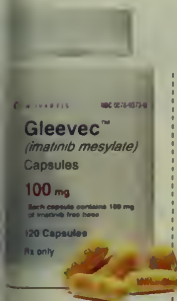
► The Suzuki GSX-R1000 motorcycle quickly became the benchmark in the highly competitive "liter-class" division of sport bikes. The 4-cylinder, 144-horsepower machine is capable of rocket-like acceleration and precise corner-carving in the hands of an experienced rider with \$10,399 to spend (714 572-1490, suzuki.com).





A TRAILBLAZER TO BEAT

◀ General Motors finally has an SUV to challenge the Ford Explorer. The Chevy TrailBlazer (\$26,000 to \$34,000) is bigger, brawnier, and better styled than the Blazer. The six-cylinder, 270-horsepower engine is more powerful than the Explorer's and more fuel efficient, too (800 222-1020, chevrolet.com/trailblazer).



SHARPSHOOTING CANCER

◀ Novartis' Gleevec represents a huge victory in the war against cancer. The drug, approved by the Food & Drug Administration in May for chronic myeloid leukemia (CML), is the first of a huge number of oncology drugs in development that precisely target cancer cells without harming healthy tissue. CML is a rare disease, but the drug also shows promise against stomach, lung, and brain cancers (877 453-3832, gleevec.com).



A SMARTER SMOKE ALARM

▲ Ever been cooking when the smoke alarm started shrieking? Now you no longer have to stand on a chair to shut it off. First Alert's \$25 SA302 model can be silenced with any remote control. In a real emergency, increasing levels of smoke will reactivate the alarm (800 323-9005, firstalert.com).



ABSORBING DEVELOPMENT

▲ The "quicker picker-upper" just got even quicker. Procter & Gamble's Bounty-in-a-Box (\$1.19) puts a new spin on paper towels, folding 40 individual towels into a tissue-like box. The thinking: Spills happen all over the house, not just in the kitchen. Accordingly, P&G has rolled out nine different box designs (800 926-8689).

(GLEEVEC AND BOUNTY) PHOTOGRAPHS BY STEVE WISBAUER

EXECUTIVE DUFFEL BAG

► In time for airlines' new one-carry-on rule comes a combination garment and duffel bag. Based on the principle that rolled-up clothes arrive with fewer wrinkles than folded ones, SkyRoll (\$170) is two bags: a detachable garment bag rolls around the duffel, held by Velcro strips and plastic fasteners (skyroll.com).



A NISSAN WITH FLAIR

▼ Refined. Reliable. Stodgy. That's the typical Japanese family sedan. Nissan is out to change that with its all-new 2002 Altima (\$17,000 to



\$29,000), a car with enough flair to grab your attention. It's no slouch in performance, either (800 647-7261, nissandriven.com).

HANDHELD HOME-MOVIE STUDIO

◀ It's the ultimate in camcorders. Hitachi's Emmy-winning DZ-MV100A records onto a DVD instead of tape. The advantage? You can edit your home movies directly on the \$2,000 camcorder or on a TV screen using the camera's remote control (800 448-2244, hitachi.com).



POCKET JUKEBOXES

◀ Apple's sleek iPod digital music player is making Mac fans the envy of the PC world. The size of a pack of cigarettes, the \$399 iPod can download 1,000 songs from Mac machines and play non-stop for more than 10 hours (800 692-7753, ipod.com). ► Panasonic's \$299 SV-SD80 e-wear player can hold only an hour or two of tunes, but makes up for it with its diminutive size (800 211-7262, panasonic.com).





Mail safety: What every concerned business executive should know.

Your employees, your customers, your revenue could all be affected. What can you do to lessen the impact?

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MIGHTY MINI

◀ Where the Minis of old were affordable transportation, the new Mini is affordable fun. BMW took the old British nameplate and transformed it into a \$22,000 sports car now sold in Europe. Due out in the U.S. in March, the Mini offers as much of BMW's "ultimate driving" as you can get in a car that has 115 horsepower (mini.com).



A FRIDGE IN THE ROUND

◀ Equator throws a curveball to the ice-box world. Its Round Refrigerator (\$3,495) features pull-out, lazy-Susan-style shelves—no more unpacking the whole fridge for those leftovers in the back. But where do you put the magnets? (800 935-1955, equatorappliances.com)

COMMERCIAL-FREE ZONE

▼ The movie studios and TV networks have hauled it into court, but ReplayTV (\$699 to \$1,999) is taking digital video recorders to the next level. Not only can you record up to 320 hours of TV programs, you can also e-mail them to friends. Better yet, the recorders automatically snip the commercials from the shows (877 737-5298, replaytv.com).



GAME BOY'S WINNING MAKEOVER

◀ Nintendo took 12 years to overhaul its seminal Game Boy system, but Game Boy Advance (\$100) is worth the wait. The horizontal handheld features a 32-bit processor, a bigger screen, and better sound. It plays old Game Boy and Game Boy Color titles and hooks into the new GameCube (800 255-3700, gameboy.com).



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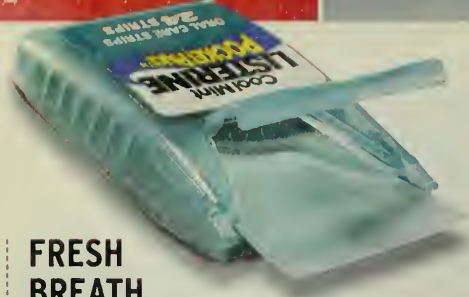
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FRESH BREATH TO GO

▲ Mouthwash on a strip of film? The idea behind Listerine PocketPaks (\$1.49 for 24 stamp-size starch-based strips) takes some getting used to. But they're more discreet than chewing gum (800 223-0182, listerine.com).

DIGITAL DELIGHT

► Kodak's EasyShare digital cameras (\$180 to \$250) are idiot-proof to shoot, plus they make prints and e-mails a cinch. The \$80 docking station moves your shots to your computer (800 235-6325, kodak.com).



BusinessWeek
e.biz

Our Favorite Clicks

Oh, the pain. About 500 Web companies closed in 2001 and 1,000 more had been acquired as of the end of October. Poor Web critics imagined futures as compadres with Maytag re-

Give.org and **Volunteer-Match.org**. With September 11 focusing our attention on donating our money and our time, these sites score. Give.org has few peers in sizing up charities, zeroing in on how much gets spent on overhead. Volunteer-Match tracks community service openings to match needs with volunteers' skills and interests.

MSN.com. Microsoft's progress in 2001 is tough to ignore. MSN Music's online radio is truly slick, mixing a broad selection of styles with software that chooses specific tunes by tempo and by the mood you want to

Fandango.com. In another blow to AOL, our critic liked this online movie ticket service better than AOL's Moviefone. It sells tickets to more theaters and was easier to use in our tests. **Snapfish.com**. Lots of sites

ChristmasStreet.com. One delightful thing about Baltimore is the holiday lunacy on 34th Street, where the blue-collar-meets-hip-artist Hampden neighborhood stages its miracle of riotously gaudy lights. It ha-

welcome to Hampden, Hon!
christmasstreet.com
the 700 block of West 34th Street
Baltimore, Maryland

let you store digital pictures and turn them into cards and gifts. Snapfish does the best job balancing the needs of people who use digital cameras and the majority who still use film. Cheap prints, prompt mail-order service, and easy-to-use tools for sharing pictures over the Web make choosing this site a snap.

Etiquettegrrls.com. We have a weakness for wiseacres, and this site for post-modern manners scratched our itch. Submit your own questions and take your chances following advice from Lesley Carlin and Honore McDonough Ervin, the site's creators. Funny and smart enough that Letitia Baldrige blurred their new book.

to be seen to be believed, as ex-residents like me know.

ChristmasStreet.com's photos and live Webcam capture this block-long scene of more than 10,000 lights and giant rooftop monuments to good cheer that pilgrims come from Washington to see. Grab the eggnog and log on.

Yeah, all this is nice—but we gave online grocery service Homeruns.com a nice review in June, too, and it closed the next



pairmen. Still, *BusinessWeek* e.biz and e.biz Online found a lot to like—even if the Web in 2001 couldn't match the innovation or élan of 1999.

Dismal.com. Talk about being in the right place at the right time: We found this site (named for the dismal science) ahead of the pack on key economic trends. It's no longer free, but decision-makers will find it worth the \$159-a-year subscription.

set. MSN's takeover of CNBC.com helps a little, and its new alliance with uber-sports site ESPN.com helps lots. Plus, early peeks at Microsoft's MyServices platform, which will help MSN software worm its way into keeping track of things ranging from money management to car maintenance, are intriguing. Archival America Online is still a better portal, but watch this space.

Etiquette
grrls.com

month. So our recommendation and 75 bucks will get your washer fixed. Tell the Maytag Man we said hi.

By Timothy J. Mullane
in New York

OUR PROCESS TO REDUCE SULFUR IN GASOLINE HELPS THOSE WHO DON'T EVEN DRIVE.



Sulfur is a naturally occurring element in gasoline and contributes to air pollution. But until recently, the methods used to remove sulfur from gasoline weren't very efficient. So Phillips is developing a new process that removes more than 90% of the sulfur in standard gasoline without significant loss of

octane or volume. It's an innovation that will help us reduce harmful emissions from cars, improve air quality and meet proposed sulfur regulations for years to come. And it's just one of the many ways we live up to the name The Performance Company.

PHILLIPS PETROLEUM COMPANY

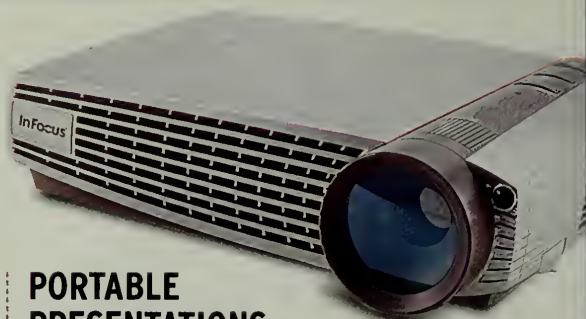


For a copy of our annual report, call 918-661-3700, write to: Phillips Annual Report, B-41, Adams Bldg., Bartlesville, OK 74004, or visit us at www.phillips66.com.



CRASH-PROOF SOFTWARE

◀ Windows XP (\$100 to \$200) combines the stability of Windows NT, Microsoft's corporate product, with easy-to-use software suitable for home use. The result promises to make crashes a thing of the past (windowsxp.com).

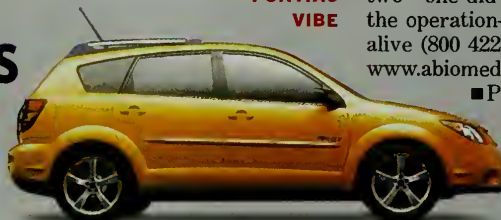


PORTABLE PRESENTATIONS

▲ Not long ago, portable video projectors for business presentations weighed 10 pounds and cost \$10,000. Now, there's the InFocus LP130. The \$3,700 unit weighs 3 pounds and can share a bag with your laptop. Turn your den into a home theater (800 294-6400, infocus.com).

Products To Watch

Will the fickle younger generation take to the sporty Pontiac Vibe, a compact wagon that goes on sale in January? Toyota did most of the engineering on the \$17,000 Vibe, but the car's styling is all Pontiac. Enthusiasts say that the GT model, with its 180-horsepower Yamaha engine, will be particularly hot. Another neat trick: The rear



PONTIAC VIBE

January (page 20). It's a full-fledged handheld computer using the Palm system and will come with either the familiar Palm handwriting-recognition pad or a tiny keyboard reminiscent of BlackBerry pagers. Flip the lid on the \$399 gizmo and your speed-dial list pops up on the screen. Place your call from that, the keypad, or a quick search of your address book (888 565-9393, handspring.com).

■ It still has a lot to prove, but the AbioCor artificial heart from Abiomed looks far more promising than past such devices. The three-pound, titani-



DIECELAND DISPOSABLE PHONE

seats fold into the floor at the push of a button to make space for all the stuff kids carry around today (800 762-2737, pontiac.com).

■ Techies are going to love the Treo, Handspring's take on the flip-phone, due in

um-and-plastic experimental heart is powered by batteries worn outside the body that transmit power without wires. It has been implanted since July in six patients with severely damaged hearts, and all but

two—one did not survive the operation—are still alive (800 422-8666, www.abiomed.com).

■ Procrastinators, cheer up! Uncle Sam has noticed that gap in your retirement savings and

produced a sweetener to help you fill it. Starting next year, workers aged 50 and up can make tax-free "catch-up" contributions to their retirement plans—an extra \$1,000 a year for 401(k) and similar employer-backed plans and \$500 for traditional IRAs. The annual bonuses step up to \$5,000 and \$1,000 by 2006.

■ Cadillac will replace the oh-so-dull Catera entry-luxury sedan in January with the sporty CTS. The \$30,000 to \$35,000 CTS is supposed to be an alternative to the sophisticated but conservative imported luxury cars. The edgy looks of the exterior may be a bit much for many buyers, but few will complain about its sporty ride.



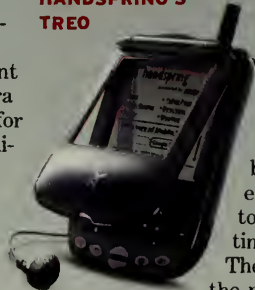
CADILLAC CTS

Caddy's engineers tested its performance on the same German track that BMW uses to develop its sporty-driving cars (800 458-8006, cadillac.com).

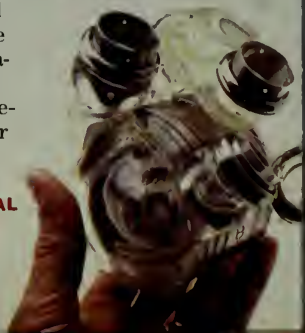
■ With throwaway wireless phones there's no excuse to be out of touch. Companies such as Hop-On and Dieceland are bringing out models loaded with up to an hour of talk time for \$10 to \$30. Their makers hope the phones will be-

come popular promotional giveaways, like phone cards emblazoned with corporate logos. With these, though, the phone is attached (714 590-4901, hop-on.com).

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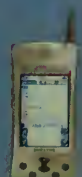
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MERCK COULD USE A FEW PEP PILLS

As patents expire, the drug giant desperately needs product

Merck & Co. has a history of going its own way in the drug industry. It was the first big drug-maker to buy a pharmacy-benefits management business, now called Merck-Medco, back in 1994. It has pushed aggressively into risky new research fields, conducting one of the biggest projects to find an HIV vaccine. And while big rivals such as Pfizer Inc. and Bristol-Myers Squibb Co. have tried to keep their new-drug pipelines flowing by pulling off major mergers or striking expensive development deals with smaller outfits, Merck Chairman and CEO Raymond V. Gilmartin has relied largely on the company's vaunted research labs.

Wall Street, however, is now questioning that independent streak as Merck enters a critical period. Patents on several of its blockbuster drugs have been expiring, exposing them to competition from cheap, generic knockoffs. At the same time, the company's pipeline looks alarmingly thin. Merck had counted on its second-biggest product, arthritis drug Vioxx, to help it through this rough patch, but now its fast growth is stalling.

"ONE-TWO PUNCH." That's why investors are anxiously awaiting Merck's annual meeting for analysts on Dec. 11. If the company doesn't unveil exciting new developments about potentially big drugs, the pressure quickly will mount for Merck to consider acquisitions or major drug-licensing deals. But the options aren't promising. Schering-Plough Corp. is often mentioned as a target, but Merck has felt that

big purchases can be more trouble than they're worth. And licensing deals are difficult to find and pricey to seal. "The one-two punch is that they have so much patent exposure but not a lot in their pipeline relative to their size," says Norman M. Fidel, health-care portfolio man-

ager at Merck shareholder Alliance Capital Management LP. "We are looking at the valley and we just don't see a lot on the other side," Gilmartin declined to comment ahead of the analysts meeting.

That reality is pounding Merck's stock. So far this year, the price is down 27%, to around \$69 a share, while the Standard & Poor's Health Care Index is off 10%. Richard T. Evans, an analyst at Sanford C. Bernstein & Co., warns that Merck's net income will climb just 6.7% this year, to \$7.3 billion, on sales of \$47.3 billion, a 17% jump over last year largely due to fast-rising—but lower-margin—sales at Merck-Medco. Next year doesn't look much better, with net income and sales both expected to rise just 8%. SG Cowen Securities Corp. expects Merck's earnings growth to average 9% from 2001 through 2005, well below the 13% industry average and the 17% that the company itself has averaged over the last four years.

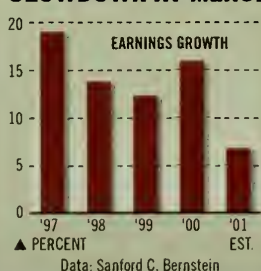
The stumble is hardly surprising considering the number of Merck products losing their patents. Last year U.S. patents expired on the stomach drug Pepcid and the hypertension drug Vasotec, which grossed a combined \$1.7 billion in the U.S. in 1999. Next year

Merck loses market exclusivity in the U.S. for its hypertension drug Prinivil, which is now racking up \$1.1 billion in U.S. sales. And, depending on the outcome of a court case, generics may also erode profits next year from the AstraZeneca PLC blockbuster stomach drug Prilosec, which Merck shares thanks to a joint

venture. Analysts figure that Merck's portion of Prilosec sales will hit \$1.2 billion this year.

Merck was depending on Vioxx to help keep the growth engine humming. Part of a new class of painkillers called Cox-2 inhibitors, Vioxx was launched in

SLOWDOWN AT MERCK



1999 on the heels of a similar Celebrex, now owned by Pharm. Both drugs were immediate hits. The last year, a study by Merck showed easy Vioxx was on stomachs, the drug's main selling point, but also indicated that patients taking Vioxx were more prone to heart attacks than patients taking an older, rival, drug. Merck believes that Vioxx doesn't cause heart problems—that instead the older drug may actually help protect the heart—but a study to prove that point has not been done yet. So in September, the Food & Drug Administration warned the company that its marketing of Vioxx poses a cardiac risk. Merck started doing that, but director of Honeywell International Inc. Chairman and CEO Lawrence A. Bossidy says the board believes the cardiac issues will be resolved. "The board has a lot of confidence that it will be a great drug."

Still, the uncertainty is hurting Vioxx in the marketplace. In June, Merck announced that the drug's sales would

MERCK'S MOUNTING WOES

PATENT EXPIRATIONS

Patents have expired or will shortly on several big sellers, including the blockbuster hypertension drug Prinivil. When patents go, cheap generic knockoffs rapidly kill sales of the original.

VIOXX HEADACHES

Growth of the blockbuster painkiller Vioxx has slowed this year after a study raised questions about whether the drug poses a cardiovascular risk.

GAPS IN THE PIPELINE

Merck's pipeline of new drugs for the next few years is thin, so investors are anxiously awaiting the company's Dec. 11 analysts meeting. If Merck doesn't outline some potential big sellers, pressure may mount for the drugmaker to make an acquisition or sign a drug-licensing deal.

GILMARTIN: *The CEO is wary of mergers as a source of new drugs*

at the low end of the \$3 billion to \$5 billion range it had laid out for this year, though that's still higher than last year's \$2.2 billion. Since then, however, some analysts have pared their sales estimates to as low as \$2.6 billion. SGWen analyst Stephen M. Scala has slashed his earlier \$4 billion estimate for Vioxx sales in 2005 by \$1 billion. Partly that's because some health maintenance organizations have balked at the high price of Cox-2 drugs and are restricting them to patients at risk of stomach problems. But with the uncertainty about cardiac problems, some physicians are prescribing less Vioxx. As Vioxx's potential fades, does Merck have another superdrug up its sleeve? Peter S. Kim, executive vice president of research and development, says Merck will disclose some promising new drug candidates now in early human testing at the Dec. 11 meeting. "It's premature to jump to the conclusion that Merck has a problem in its pipeline," he says. Still, based on what Merck has disclosed so far, the near-term pipeline looks lean. It

includes a new Cox-2 drug called Arcoxia that may be more effective than its competitors but which may face the same cardiac questions dogging Vioxx, and a new antidepressant that could be a blockbuster but is far from a sure thing.

In a few years Merck will face yet another major setback: the end of U.S. patent protection for its biggest drug, the cholesterol-lowering Zocor, which is worth \$6.6 billion a year. Generics are expected to hit in the middle of 2006, and while that may seem far away, by then Zocor is expected to account for roughly a third of the company's total drug sales. To head off that threat, Merck is linking up with Schering-Plough to create a pill that combines Zocor with a new cholesterol medication from Schering. The combi-

nation is expected to be more potent than Zocor alone and Merck will try to switch patients to the new therapy—which will enjoy years of patent protection—before Zocor generics hit the market. But there's a pitfall: Even if the combination is a hit, Merck must split the profits with Schering.

LICENSING DEAL? That's why a number of analysts say it makes sense for Merck to buy \$10-billion Schering. It would hold onto all the profits from the new Zocor combination therapy and generate big cost savings to help boost earnings during a period of weak growth. But Merck's Gilmartin has maintained for years that Merck is better off developing its own breakthrough drugs rather than jumping into the disruption of a megamerger. Schering declines to comment. Dr. John R. Borzilleri, a senior vice-president at State Street Research & Management Co., a Merck investor, says Gilmartin could instead buy a smaller European pharmaceutical company to fill its pipeline in the near term. Or Merck could sign a deal to market a product being developed by a smaller company, as Bristol-Myers did recently with a promising cancer drug in the works at ImClone Systems Inc. But potential blockbusters aren't plentiful and don't come cheap. Says Borzilleri, "There are a lot of people looking

ing to [acquire or license drugs], so they could find themselves in a bidding war."

With no quick fix in sight, Merck is focusing on energizing its research efforts. The company has recruited new scientists, most notably the 43-year-old Kim from Massachusetts Institute of Technology, who has done groundbreaking work on HIV. Kim is expected to take over Merck's massive R&D operation after the current chief, Dr. Edward M. Scolnick, 60, retires in the next few years. The company has also signed a series of deals to bulk up its scientific expertise. Earlier this year, for example, it bought Rosetta Inpharmatics Inc., a genomics company.

None of this, it appears, will plug the near-term hole in the pipeline. So is it time for Merck to break with tradition? "They desperately need to acquire product," says Borzilleri. "I don't see how they do it on their own." If Merck doesn't soon have a breakthrough or two to wow Wall Street, that criticism will grow only louder.

By Amy Barrett in Philadelphia





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Insurance Innovation



Mining the Capital Markets

The insurance industry, which has suffered for years from rampant premium competition, may finally be seeing the light of better days.

In its Insurance Industry Outlook 2001, BusinessWeek reports that “a decade of cutthroat pricing and excess capacity has taken its toll on property and casualty companies. In 1999 alone, this benighted sector lost nearly 26% of its stock market value. But the outlook improved steadily last year, and prospects for 2001 are upbeat: premium growth should hit 7%, suggesting that the industry is now expanding at the fastest rate in 15 years.”

Some of the reasons for this improved outlook are predictable. The BusinessWeek report notes that “Insurers are showing signs that they are no longer shedding prices just to win business or gain market share.” And, in addition, insurers’ “investment earnings

are rising. Thanks in part to higher interest rates and increased earnings from bonds, investment income grew by 2.2% [in 2000] compared with a 3.3% drop in all of 1999.”

“Insurers are showing signs that they are no longer shedding prices just to win business or gain market share.”

Improving Through Innovation

But in many ways the increasing robustness of the insurance industry may have less to do with business cycles and more with another trait that is suddenly becoming more pronounced in the insurance industry: innovation. For a generation, of course, product innovation has been the hallmark of the financial services sector:

➤ The 1971 collapse of the Bretton Woods system's fixed exchange rates introduced significant currency risk into the market — and led to the creation of currency hedging vehicles like futures and options contracts.

➤ The rise in inflation in the early 1970s, which squeezed banks whose depository interest rates were tightly limited by the Federal Reserve's Regulation Q, ushered in the unregulated Eurodollar and commercial paper markets.

“

If a predefined catastrophic event does occur, investors lose interest, principal, or both, and their funds are transferred to the insured.

”

➤ The prepayment risks inherent in mortgage-backed securities prompted the development in the late 1970s of collateralized mortgage obligations (CMOs), which redirected cash flows from the underlying mortgage pools to risk-pegged bond classes.

Insurers, by contrast, have historically been slower to innovate than some of their financial services counterparts. In a section of its annual insurance industry outlook entitled “Competitive Challenges: Insurers Respond, and It's About Time!” Deloitte Consulting admits that “U.S. insurers have dragged their feet” in this critical respect. But that may be changing. For the future, says Deloitte, the

“winners” will be those that successfully “compete for capital to fund strategic initiatives” through such means as “development of a broader portfolio of financial product offerings...”

Responding to Catastrophe

One area in which innovation is increasingly prevalent is in the use of capital markets to cushion against growing disaster-related property losses. This problem was especially apparent following Hurricane Andrew and the Northridge earthquake in the early 1990s, when property casualty reinsurance — the traditional disaster-indemnification vehicle — grew in short supply and its premium rates more than doubled.

In response, a small number of insurers began developing a new class of financial instrument designed to transfer insurance risk to the capital markets, deployed in such forms as catastrophe bonds, swaps, and options. Since then, nearly \$12 billion worth of these capital market insurance solutions have been issued worldwide.

Catastrophe bonds (popularly called “cat bonds”) account for nearly half this total. They work like this. An insurer-created trust account enters into a reinsurance contract with the insured entity and simultaneously issues cat bonds to investors. If no loss occurs, investors receive a return of principal and a stream of coupon payments that compensate them for the use of their funds and their risk exposure. On the other hand, if a predefined catastrophic event does occur, investors lose interest, principal, or both, and their funds are transferred to the insured. Swaps and options are similar, involving a series of fixed, predefined payments exchanged for a series of floating payments whose values turn on the occurrence of specified loss events.

A Compelling Logic

Insurance innovations such as catastrophe bonds have emerged in response to market conditions that



Royal Bank of Canada
Committed Capital Facility
Agreement

CAD 200 million
November 2000

Swiss Re New Markets.
Structurer and Arranger



California Earthquake
Authority
Securitization of California
Earthquake Risk

USD 100 million
February 2001

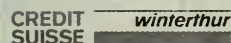
Swiss Re Capital Markets
Corporation:
Co-Lead Manager



American Equity
Life Insurance Company
Funded Statutory Surplus
Relief

USD 35 million
January 2001

Swiss Re New Markets:
Structurer, Arranger
and Lead Manager



Winterthur Insurance
Subsidiary of
Credit Suisse Group
Acquisition of Belgian
Non-Life Insurance
Businesses of CGNU plc
EUR 117 million
May 2001
Fox-Pitt, Kelton:
Sole Financial Adviser



Peel Hunt plc
Recommended Offer
by KBC Bank NV

GBP 265 million
December 2000

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FRIENDS PROVIDENT

Friends Provident plc
Initial Public Offering of
1,025 Million Shares

GBP 2,300 million
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Fox-Pitt, Kelton:
Co-Lead Manager



AEGON NV
Public Offering
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EUR 1,705 million

June 2001
Fox-Pitt, Kelton:
Co-Manager in Secondary
Equity Issue



MLP AG
Buy-out of Minorities and
Capital Restructuring
Undisclosed Amount

October 2000
Fox-Pitt, Kelton:
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admit no other realistic solution. As the European insurance giant Swiss Re explains in a recent report, "growing population densities, increasing wealth, and rising concentrations of property in endangered areas have created a clear long-term trend toward natural catastrophe losses of increasing severity." For instance, "the number of inflation-adjusted billion-dollar natural catastrophes grew from seven in the 1970s to nine in the 1980s and to 32 in the 1990s."

In the face of these potentially huge losses, the logic of novel instruments like



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events to be calamitous. Sometimes, it's the small incidents that can devastate families and send insurance rates sky-high.

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UL also features informative safety tips for Fall and Winter on its web site — information that's well worth printing and posting around the home or office. Check it out at www.ul.com.

catastrophe bonds is compelling. Publicly traded stocks and bonds have a total market value of some \$60 trillion. Even a \$250 billion catastrophe event (twice the projected cost of a devastating U.S. earthquake) would represent less than 0.5% of the global market portfolio. Fluctuations of this magnitude, while hardly trivial, are a normal daily occurrence in the securities market.

Catastrophe bonds also offer significant benefits to investors. Because of their potential for markedly greater-than-expected payouts (along with other factors), catastrophe bonds typically pay rates that are higher than corporate debt and traditional asset-backed paper, like mortgage-backed securities and credit-card receivables, carrying the same credit rating. For example, a sample of 17 cat

bonds issued between 1997 and 2000 offered an average spread of 4.2% over the risk-free London Interbank Offered Rate (LIBOR), even though their expected losses averaged just 0.6%.

Extending the Reach of Insurance

The catastrophe bond market has grown dramatically since its origination a mere seven years ago. The first such issue, in 1994, was valued at a mere \$85 million, but annual issuance volume thereafter quickly swelled to \$1 billion in 1997 and \$1.4 billion in 1998. Then, in 1999 and 2000, growth halted, due in large part to a 21% decline in property casualty reinsurance prices that undercut the economic value of the catastrophe securitization instruments.

Most observers expect these numbers to turn about sharply in the years ahead. Analysts at Swiss Re, for instance, project that annual catastrophe securitizations will reach \$10 billion by 2010. But that may be just the beginning, as capital market solutions are expected to gradually move beyond low frequency/high severity risks like natural disasters into middle frequency/middle severity fields like life insurance securitization and motor vehicle insurance.

While conceding that "capital market solutions will not be a substitute for traditional reinsurance, but a complement," the Swiss Re analysts nevertheless conclude that, "if they deliver on their promise of improved...liquidity and efficiency for certain lines of business, [such instruments]... have the potential to expand the limits of insurability." •

Author: Robert Hopkins, a technology writer based in California.

Design: Shostak Studios, Inc.

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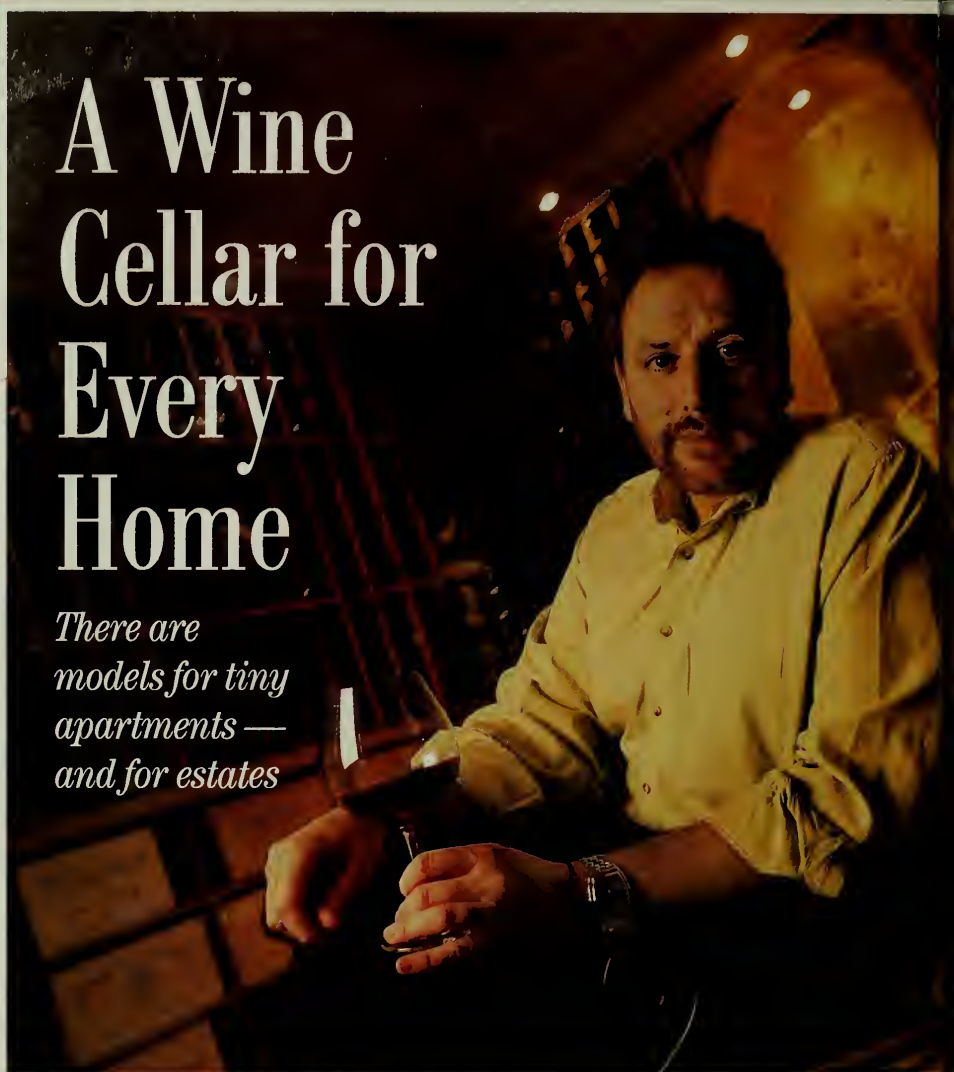
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HOW TO
STORE WINE
TO PRESERVE
ITS VALUE

BusinessWeek Lifestyle

A Wine Cellar for Every Home

There are models for tiny apartments — and for estates



BY ROY FURCHGOTT

In early October, wine enthusiast Alan Statman received a mouth-watering invitation to taste rare vintages that a friend had been aging for a decade. But when the glasses were hoisted, instead of sensing rich fruits and rounded tannins, "it tasted like I would expect sewage to taste," said Statman, who practices corporate law in Cincinnati.

What happened? The wines had been stored in a basement that wasn't cool or humid enough. With some 1,500 bottles that would have been worth an average of \$250 each if they had been properly stored, his friend may have lost \$375,000 worth of wine.

Worst of all, for about \$3,000, the loss could have been prevented. All it takes is some insulation and a special cooling unit to create a wine cellar that might not only preserve a wine's value but even enhance it. "Great storage often adds a significant premium—10% and upwards," says Richard Brierley, head of New York wine sales at Christie's.

Wine cellars aren't just for the rich anymore—

and you don't need a naturally cool, humid storage room under the manse, either. Advances in insulation and cooling have led to handsome, compact cabinet cellars suitable for preserving wine in the tiniest apartment. People who want a custom cellar with, say, a tasting table that accommodates six have more coolers, gear, and racks to choose from than ever before.

Proper storage lets smart oenophiles buy bottles that are young and cheap. Statman, who keeps his wines in an 1,800-bottle showplace room featuring Italian tiles custom painted with cherubs and grapevines, bought a \$150 Bordeaux in 1991 that's worth about \$750 today. It's hard to accrue \$20 bottles that could be worth \$100 when they're ready to drink.

Of course, not every wine benefits from aging. The average dinner wine can sit on a kitchen counter for months unharmed. But that's not true of the finer stuff. "Wine is a fragile liquid and needs to be kept correctly," says Mark Wessels of Addy Bassin's MacArthur Wine & Spirits in Washington. Wine that is too warm—say, 70°F or more—can "cook"

Wines

COOL CACHE:

Statman's
cellar
stores up to
1,800 bottles

a syrupy muck. Low humidity can cause corks to dry out. That may let air into the bottle, causing

oxidation that spoils the wine. Vibration in a cellar can keep solids in the wine suspended when they should clump together and fall to the bottom of the bottle. Otherwise, the wine can give you that dry-tongue feeling.

Mere refrigeration won't do the job. The standard fridge is generally too cold, and the thermostats are not accurate enough and don't regulate humidity. Cabinet cellars, which can hold up to 800 bottles, are one good solution. At a cost of \$1,000 to \$3,500, they come in styles from sleek steel and glass to Victorian oak. Many have enough flair to sit smartly in your dining room.

If you base your choice on storage capacity, beware: Some manufacturers make their units appear to hold more bottles by making the cubbies smaller. These racks won't fit Champagnes, Rhônes, or even some chardonnays. So it's a good idea to take the dimensions of the bottles you want to store and make sure they'll fit. Also be careful about bottle counts. One cellar has a 520-bottle capacity when bottles are stacked, but when racks are installed, it holds only about 360.

Another caveat: Make sure you can get the cabinet where you want it to go. "One out of 12 units come back because they don't fit through the door or down the stairway," says Robert Orenstein, president of International Wine Accessories. To keep from getting stuck with a \$1,000 round-trip shipping bill, have the shipper to measure your home first. It usually costs about \$50. Then, if the cabinet cellar doesn't fit, says Orenstein, the mover covers shipping.

None of that is a problem if you custom-build a cellar. Custom-building becomes cost-efficient if you plan to store 1,000 or so bottles. It's because the same 10-to-\$1,500 chiller used in an 800-bottle cabinet can cool a 1,500-bottle cellar. The rest of the materials—2-inch-by-4-inch framing, a plastic vapor barrier, foam insulation, wine racks, and insulated doors—can cost less than \$500.

At that price, "you are going to get the aesthetics," says Art Lokar of Estate Wine Cellars in Ironia, Mich. For many collectors, the aesthetics

Best Cellars

If you're thinking of adding a custom-built wine cellar, here are some important components

are, as important as the wine. "Everyone wants to feel like they are walking into an old place in Europe," says architect Susan Geier of Encinitas, Calif., who designs wine cellars. "From oozing mortar to 400-year-old tiles, we do anything we can do to make it cruddy." Her clients typically spend from \$10,000 for a 10-foot-by-7-foot cellar to \$60,000 for a larger room with 400-year-old imported French tiles on the walls and arched cabinets.

Still, even the fanciest cellars can have problems. Few builders understand the special requirements, like the proper installation of the vapor barrier (table). Flub the barrier, and moisture escapes into a home's walls, where it can rot the house from the inside. "People call us because the floor tile in the room above is caving in," said Tony Wilke of Wine Cellar Innovations, a leading wine rack maker. Other common errors: cooling the cellar with underpowered air-conditioning instead of refrigeration, skimping on insulation, and failing to use low-heat lighting that reduces the chance of condensation or drips.

For a basic wine cellar, specialist craftsmen tend to be pricey. "We find you are best off hiring a handyman," says Orenstein—but only if you supervise to make sure the job gets done right. Both Orenstein's company, IWA (800 527-4072), and competitor Wine Enthusiast (800 356-8466) offer free design consultation, including building instructions and help with floor plans. Specialists tend to charge at least \$5 per bottle storage, about five times the fee of a handyman under your supervision.

Robert Beson, president of Sagimore Capital, a real estate investing company near Detroit, hired a specialist to build his dream cellar, and he listened when he was warned that most people underestimate their needs. Beson nearly doubled his plan to accommodate 2,900 bottles in a room with a tasting table for six, antiqued plaster walls, and tumbled marble floors.

It took some seven months and about \$70,000 for Beson's cellar to be constructed, and it is already largely filled with wine. "I suppose I got carried away a little bit, but I am glad I have it now," he says. Surely his friends, with whom he shares bottles from his vast collection, will drink a toast to that. ■

VAPOR BARRIER Plastic sheeting between the cellar's exterior wall and insulation keeps humidity and condensation from seeping into a home's walls. Use at least ¼-inch plastic.

PROPER INSULATION The more insulation, the less work for the chiller. Use foam block insulation rated a minimum of R-21.5 in the walls and R-46 in the ceilings.

REDWOOD RACKS Solid redwood won't rot or warp. Be careful if giving it a decorative stain; uncured finishes can emit gasses that might taint the wine.

LOW-HEAT LIGHTING Use fluorescent or thermally insulated lights. Otherwise heat from the lights might cause condensation that leads to a short circuit, or even a steady drip into the cellar.

SPLIT COOLING SYSTEM This refrigeration unit for high-end cellars puts condensers and vents outside the house so the system runs quietly with less vibration.



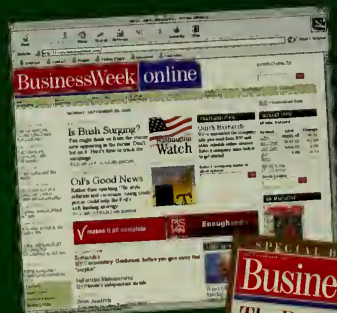
WINE ON WHEELS: A portable unit



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Your Performance Review: Make it Perform

A good evaluation is more important than ever in a downturn

BY SUSAN SCHERREIK

Like most employees, you're probably used to the boss giving you a perfunctory yearend performance review. But don't count on a routine checkup this year. "Companies that were giving everyone an easy pass a year ago are now subjecting employees to more stringent reviews and marking the poorest performers for dismissal," says Kathy Gagné, a principal at Cambria Consulting, a human resources firm in Boston.

In flush economic times, many companies treat performance reviews as little more than the paperwork required before granting annual raises. When the economy turns down, however, companies use these evaluations to weed out their weakest staff. At performance reviews, bosses

usually rank subordinates by how well they've met a handful of goals set the year before. What makes the process especially dicey this year is that many employees have fallen short of sales targets and other objectives in a tough business environment.

If you fall into this category, don't panic. The key to a positive review is to demonstrate how you've adapted to changed business circumstances. "Prepare a list of creative ways you're solving problems with limited resources,"

advises Madeleine Swain, a management consultant in New York. Say your company curtailed business travel after September 11, which interfered with your original goal of bringing far-flung staff together more frequently. In this case, inform your boss you're holding fewer but more comprehensive meetings or that you're

Your Career



conducting more teleconferences.

You'll look especially strong if you can show how your work bolsters the bottom line. For example, during a recent performance review Bob Nelson asked the comptroller at his 10-employee management-training company in San Diego to find ways to get clients to pay sooner. One of the comptroller's solutions was to have Nelson call clients and ask a favor: that they check with their accounts-payable department about the status of his company's account. "In this environment, I need my finance person to help drive the numbers, not just report them," says Nelson, who is the author of *1001 Ways to Reward Employees* and other management books.

FINANCIAL FOCUS. Similarly, Angela Kozlakowski says that two years ago, when she was a creative services director at a photography-licensing agency in New York, her boss criticized her during a performance review for not framing requests in dollar terms. "I would say, 'We need new Macintosh computers for our designers because they're state of the art,' rather than say that if the designers had Macs, they would spend 25% less time on a project," Kozlakowski says. The company hired Swain, the management consultant, to help Kozlakowski focus on the financial aspects of her job, which led to a promotion.

Rather than dwell on what you didn't do during the past year, focus on mapping out your future plans. At most companies, employees and supervisors work together to set the employee's goals. The key is to be as specific as possible and to ask for any help or training you need.

At PPG Industries, a Pittsburgh-based paint and glass manufacturer that employs 36,000 worldwide, employee objectives are dubbed "SMART goals," an acronym for "Specific, Measurable, Agreed-upon by employee and manager,

Realistic, and Timebound," says George Krock, director of human resources planning and development. Before the SMART goals system was implemented three years ago, a sales manager would simply be directed to boost production over the next year, Krock says. Now, she would be asked to develop, by Sept. 30, three new customers in the Southeast region with annual volume of \$100,000.

Performance evaluations are more challenging for employees who don't work in the place as the boss. But the situation may get tougher this year because of business travel cuts. If you find yourself increasingly a "real" employee, ask your supervisor if you can set up an evaluation document that both of you can gain access to by computer, suggests Gagnon, a Boston consultant. By doing monthly or quarterly updates, you can keep your boss informed.

Even the best workers should prepare to take some criticism. Don't act defensively. Instead, discuss what you learned from a failure and how you'll do things differently, says Robert Gold, co-author of *The Complete Idiot's Guide to Performance Appraisals*.

Typically, companies rank employees on a scale of 1 to 5 or give them an A, B, or C. When supervisors have sole discretion over the evaluation, they tend to give above-average marks, human resources experts say. That's why a growing number of companies have switched to "forced ranking" systems, which require supervisors to put a certain percentage of their staff into each rating category.

Forced ranking or not, you needn't accept a poor evaluation. Immediately contact your human resources department to see if your company has a formal objection process, suggests Coens, a Lansing (Mich.) labor lawyer and co-author of *Abolishing Performance Appraisals*. Sometimes companies will only let you file complaints within a few days of the review. The best way to overturn a poor review is with evidence that your supervisor is mistaken.

VOICING YOUR OBJECTIONS. If your company doesn't have a formal complaint process, talk with your boss to voice your objections. Also, that your written response be put in your file. If you are denied a bonus or raise or fired as a result of your review and believe you and other employees were unfairly singled out because of race, sex, or age, you can file a complaint with your state's civil rights agency or the federal Equal Employment Opportunity Commission. You can also sue your former employer for discrimination and other unfair practices that violate company policy. Employees at Ford recently sued the auto maker for alleged discriminatory practices tied to a forced ranking system for managers. Ford is settling its lawsuits, and in July dropped the forced ranking aspect of its appraisals.

Done right, however, performance reviews can motivate employees and keep everyone focused on key goals. So do your part to make sure the session goes smoothly. In today's chilly business climate, your job could depend upon it.

When You're Appraising Others...

GIVE HONEST FEEDBACK

Avoid the common mistake many managers make of giving problem employees "above average" reviews because of fear of confrontation.

ASK QUESTIONS

Employees often won't volunteer information you need to know. Ask them questions like "Do you have problems and stresses?" and "Do you understand your current job responsibilities and how they are evolving?"

FOCUS ON THE FUTURE

Most performance reviews concentrate on what the employee did the past year. Instead, focus on upcoming goals and see what training or other help the employee needs to meet them.

COMMUNICATE COMPANY GOALS

Use the performance review to keep employees informed of shifts in company's priorities because of a tough business climate.

TRAFFIC INCREASES

we know

they know

COST REDUCTIONS

IBM's reliable @ server technology and proven industry expertise. J.D. Edwards' collaborative enterprise software. Together they create scalable integrated e-business solutions for mid-sized companies. Rapid deployment, low total cost of ownership, less complex e-business – get it all at ibm.com/solutions



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Merger Funds Find Their Place in the Sun

Their steady returns look pretty good in today's market

BY LEWIS BRAHAM

For many years, the Merger Fund was the only mutual fund to focus exclusively on merger arbitrage. Such a strategy capitalizes on the disparity in price between two companies planning to merge. The returns are not great, but they are fairly steady. Merger Fund's best year was 1993, when it was up 17.7%. That explains, perhaps, why the Merger Fund had a de facto monopoly for so long.

No more. The Arbitrage Fund opened last

whether or not merger deals get done," says Edward Strafaci, portfolio manager of Lipper Merger Fund. Mergers take place in good times and bad. "In a difficult business climate, companies have as much or greater need to make acquisitions because they need scale to stay alive," Strafaci adds. Those acquisitions are cheap when stock prices are down.

"SPREAD." Merger arbitrage portfolios have been available to institutional investors, yet entry in the mutual-fund world has been limited. The open end Merger Fund often closes its doors to new investors to keep its asset size manageable (it's now \$1.1 billion). Recently, its manager, Westchester Capital Management, sued Lipper & Co., parent of the Lipper Merger Fund, for trademark infringement. Citing the suit, Westchester Capital declined to comment.

Here's how merger arbitrage works: When one company acquires another, it agrees to pay a premium above the target company's current stock price. The arbitrageur tries to capture the difference, or "spread," between the target's current price and its acquisition price. The reason for the difference is that the deal could fall apart.

In cash deals, the arbs often just buy the target. With Ralston Purina, which Nestlé agreed to acquire for \$33.50 a share, an arb buys Purina, at its current price of \$33, and waits for the deal to close. If it does, he has made 50 cents spread, a 1.5% return. If the deal closes in one month, it's the equivalent of an 18% annualized return. If the deal falls apart, Purina's stock price is the likely tank—which is why arbs' success depends on smart analysis. Sometimes regulators block deals or buyers can't raise the cash.

Many deals are exchanges of stock. For instance, last spring Tyco International agreed to acquire medical-equipment maker C.R. Bard, paying 1.13 shares of Tyco for every share of Bard. Here arbs take a different tack, selling short 1.13 shares of Tyco for every share of Bard held.

Since Bard shareholders will be getting paid in Tyco stock, shorting protects them from a drop in Tyco, which will make the exchange less valuable. But this is a riskless transaction. "If the Bard-Tyco deal breaks up, I have two potential losses in my hand," says John Orrico, portfolio manager of the Arbitrage Fund. Both his long and short bets would probably lose money.

Still, botched deals usually have a minimal impact on well-diversified funds. "About five out of every hundred deals we do don't close," says Mario Gabelli, manager of Enterprise Mergers & Acquisitions. Gabelli, who runs the arb-driven Gabelli ABC Fund, further dampens his risk by sticking to cash deals.

None of these funds will ever be the stars of the bull market. That's not their goal. "Our target return is 10% to 14% a year," says Strafaci. That's a far cry from the halcyon days of the '90s. But now, 10% to 14% looks pretty good.



**Mergers
For The
Masses**

FUND (SYMBOL)	TOTAL RETURN*	MINIMUM INVESTMENT	EXPENSE RATIO	PHONE (1-800)
ARBITRAGE FUND**	6.3%	\$2,000	1.95%	295-4485
ENTERPRISE M&A FUND EMAAX	1.2***	1,000	1.95	432-4320
GABELLI ABC FUND GABCX	4.1	25,000	1.50	422-3554
LIPPER MERGER FUND LMRFX	-0.8****	10,000	2.00	547-7379
MERGER FUND MERFX	2.3	2,000	1.34	343-8959

*Includes appreciation plus reinvestment of dividends and capital gains, before taxes. Year-to-date returns as of Dec. 3, 2001. **No symbol, call or go to www.thearbfund.com ***Since inception, Feb. 28, 2001. ****Since inception, Aug. 31, 2001 Data: Morningstar, fund companies

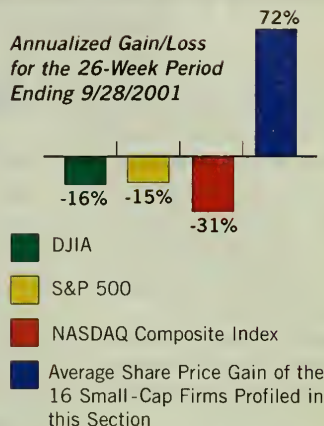
year, and both the Lipper Merger Fund and the Enterprise Mergers & Acquisitions Fund came along this year. In a period when most funds are posting negative returns, the arb funds' small but positive results look mighty good. What really makes them glow is their low risk. Over the last 10 years, the Merger Fund had only 28% of the volatility of Standard & Poor's 500-stock index but produced 90% of the return.

How do merger arb funds stay so steady? "The driving force behind our performance is

THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING SMALL-CAP COMPANIES AS OF 9/28/01

From approximately 1,700 domestic companies with market capitalizations of 200 million to one billion dollars, the following pages highlight selected top-ranking firms, in terms of share price performance for the 26-week period ending 9/28/01. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. And while past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a small-cap investor's close consideration.



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Key Manager Statement

"The third quarter of 2001 marks the 34th consecutive quarter of increased membership revenues and active memberships. We continue to benefit from significant positive cash flow and our membership base has increased 20 percent from September 30, 2000 to September 30, 2001. We are changing the way legal services are delivered and providing middle-income families access to justice"

Harland C. Stonecipher
Chairman & CEO

Emisphere Technologies, Inc. • EMIS • Drug Delivery

Roseton, NY • IR Contact: Dory Lombardo-Vaiquette • 914-785-4742
www.emisphere.com

Emisphere Technologies, Inc. is a biopharmaceutical company pioneering the oral delivery of otherwise injectable drugs. Emisphere's unique and broadly applicable platform technology uses proprietary microparticles (Emisphere® delivery agents) to mimic the body's natural transport process, enabling the gastrointestinal absorption of proteins, peptides and other macromolecules produced by pharmaceutical or biotechnology companies.

Emisphere formulations that are proprietary or partnered with some of the world's leading pharmaceutical companies have advanced into human trials. This includes an oral heparin solution in Phase III for the prevention of deep vein thrombosis and an oral formulation of insulin in Phase II, which Emisphere recently began testing in Type II diabetics. Preliminary data continue to support Emisphere's belief that a commercially viable oral formulation of insulin can be achieved and the Company plans to aggressively develop this program in 2002.

As of 11-15-2001

CURRENT SHARE PRICE	\$25.04
STOCKHOLDER'S EQUITY	\$157 M
COM. SHARES OUTSTANDING	17.8 M
CASH AND INVESTMENTS	\$162 M

DRS Technologies, Inc. • DRS • Defense

Parsippany, NJ • IR Contact: Patricia M. Williamson, VP, Corp. Communications
973-898-1500 • www.drs.com



DRS Technologies is a leading supplier of defense electronics systems, providing high-technology products and services to government and commercial customers worldwide. DRS develops and manufactures a broad range of mission-essential systems and components in the areas of communications, combat systems, rugged computers, electro-optics, data storage, digital imaging, flight safety and space that support the military's objectives for combat, surveillance and intelligence. These systems are provided to all branches of the U.S. military, government intelligence agencies, major aerospace and defense contractors, and international military forces.

Key Manager Statement

"With over 30 years of experience, DRS is transforming leading edge technologies into critical defense electronics systems that operate on the military's frontline ground, sea and air platforms. After a record year in fiscal 2001, DRS is positioned to continue to deliver increased profitability and robust top line growth for fiscal 2002."

Mark S. Newman, CEO

Kinross Gold Corporation • KGC • Gold Mining

Toronto, Canada • IR Contact: Gordon McCreary • 416 365-5123
www.kinross.com

Kinross is the fifth largest North American based primary gold producer with annual gold production of almost one million ounces. Historically, gold equities have exhibited an inverse correlation to the performance of the US dollar and equity indexes. Kinross has three core assets in the United States, Canada and Russia that annually produce about 800,000 ounces of gold for Kinross at a total cash cost of approximately \$190 per ounce.

The company is highly leveraged to changes in the gold price due to its large production and reserves/resources, small gold hedge book and perceived financial leverage.



Key Manager Statement

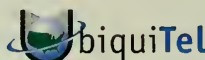
"Kinross has made significant progress in reducing our total cash costs of production from a high of \$268 per ounce in 1997 to \$191 in the current year to date, while improving our balance sheet markedly. Kinross is poised to outperform in an improving gold price environment."

Robert Buchan, Chairman & CEO

THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

UbiquiTel Inc. • UPCS • Wireless Telecommunications

Conshohocken, PA • IR Contact: Karen Pisciotta • 212-838-3777
www.ubiquitelpcs.com



Key Manager Statement

"During the third quarter, UbiquiTel delivered 177% revenue growth, to \$30.7 million, increased subscribers by 43.5%, approximately 40,000, and successfully integrated our acquisition of VIA Wireless. As a result, we have increased our operations and financial goals 15% to 20% across the board."

Don Harris, Chairman,
President & CEO

Clark/Bardes Consulting • CLKB • Financial Services

Barrington, IL • IR Contact: Jim Radosevich, VP Corporate Finance & IR
847-304-5800 • www.clarkbardes.com

Clark/Bardes Consulting Clark/Bardes Consulting is a national firm focused on helping companies keep their best people by providing a full array of executive compensation and benefit solutions. With over 3,400

corporate, healthcare and banking clients, the company is a single-source provider of products and services for the design, implementation, funding and administration of executive compensation and benefits programs. The company is an active consolidator in a fragmented industry, having successfully completed seventeen acquisitions since Sept. 1997, for a total purchase price of \$225.9M. The company's 5-year compound annual revenue and EBITA growth rates are 45% and 67%, respectively.

Key Manager Statement

"We are the clear market leader in executive compensation and benefits consulting. Our client base has grown by more than 25 percent this past year as we have expanded our wide array of service and solution offerings. We have and will continue to strengthen the company through our successful mix of organic and acquisitive growth."

Tom Wamberg, Chairman & CEO

Helen of Troy, Ltd. • HELE • Personal Care

El Paso, TX • IR Contact: Robert Spear • 915-225-4748
www.hotus.com

Helen of Troy

Helen of Troy, Ltd. is a leading designer, producer and marketer of brand name personal care products such as hair dyes, curling irons, foot baths, massagers and clippers, as well as brushes, combs, hair accessories and mirrors. Helen of Troy's products are sold worldwide under the highly recognized licensed brand names of Revlon, Vidal Sassoon, Barbie, Sunbeam, Oster, and Dr. Scholl's. Helen of Troy's owned trade names include Dazey, Caruso, Karina and DCNL.

	FY2001	1st Half FY2001	1st Half FY2002	% Inc.
Net Sales	\$361.4M	\$164.3M	\$205.6M	25%
Net Income	\$17.3M	\$6.1M	\$11.9M	93%
E.P.S. (Diluted)	\$0.60	\$0.21	\$0.41	93%

Key Manager Statement

"For over 33 years, Helen of Troy has worked diligently to build consumer brand loyalty. Only by providing a broad selection of innovative products at prices that appeal to our customers, have we emerged as market leaders within the personal care products industry."

Gerald J. Rubin
Chairman, President & CEO

Theragenics Corporation™ • TGX • Medical Devices

Bufo, GA • IR Contact: Ron Warren • 770-271-0233 • 800-998-7777
www.theragenics.com • www.theraseed.com

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TheraSeed® implants have been shown in independent studies to offer success rates that are comparable to or better than other conventional therapies, with a reduced recovery time and incidence of side effects.

Key Manager Statement

"By the end of 2001, Theragenics will have treated nearly 10,000 men for prostate cancer with radiation, that rival traditional treatments such as surgery, with fewer complications and a reduced recovery time. The Company is now exploring the use of Palladium-103, the most active ingredient in TheraSeed® for other medical applications."

M. Christine Jacobs, Chairman
President & CEO

Hughes Supply, Inc. • HUG • Wholesale Distributor

Orlando, FL • IR Contact: Steve Zepf • 407-841-4755
www.hughessupply.com



Hughes Supply, Inc., founded in 1928, has grown to become one of the nation's largest diversified wholesale distributors. Hughes distributes over 240,000 construction and infrastructure products through more than 450 wholesale outlets located in 34 states and Mexico.

The Hughes plan is to be the best in customer service in each of the industries it serves, while also being the most efficient. To meet that challenge, Hughes will use its strength of diversity and its power and tradition. Hughes is retaining the best of the old, but is also moving forward with new leadership, direction and opportunities. The primary focus is offering Hughes' customers the finest in Solutions, Supply and Service.

Key Manager Statement

"From an economic standpoint, if you were to forecast what business sectors might be expected to outperform the general economy over the next ten years, the answer would certainly involve both energy and infrastructure management. From water to sewer, to PVF, and from electric to plumbing, I can't think of any company that is better prepared to handle these trends than Hughes."

Tom Morgan, President & CEO

First Community Bancshares, Inc. • FCBC • Financial Services

Bluefield, VA • IR Contact: Robert L. Schumacher
bschumacher@fcbinc.com • www.fcbinc.com



First Community Bancshares, Inc. is a \$1.3 billion holding company headquartered in Bluefield, Virginia. The Company, through its wholly owned subsidiary First Community Bank, N.A., operates 34 branches in West Virginia, Virginia, and North Carolina. Pending acquisitions will bring the total bank branches to 38 before year-end 2001. FCB also owns United First Mortgage, Inc. based in Richmond, Virginia. FCB holds an interest in Bankers Insurance, L.L.C., a general insurance agency owned by a consortium of state and national banks and thrifts located in Virginia. The Company continues to perform well with record earnings and deposit growth despite a slowing economy.

Key Manager Statement

"For the nine months ended September 30, 2001, earnings per share increased 14.4% and 9.9%. The fact that we could achieve these results despite such difficult economic times and continued pressure on the interest margin, is an indication of the strength of our franchise."

John M. Mendez, Pres. & CEO

THE EQUITY INVESTOR'S 26-WEEK SMALL-CAP REVIEW

Midwest Banc Holdings, Inc. • MBHI • Banking

Deer Park, IL • IR Contact: Edward H. Sibbald • 708-865-1053
www.midwestbanc.com

Midwest Banc Holdings, Inc. is a community-based holding company operating four community banks in the greater metro-Chicago area and Western IL. It's the eighth largest publicly traded, bank holding company in IL with total assets and 17 banking centers at Sept. 30, 2001. Average annual asset growth of 28.5% in the past five years. It is considered a high-performance bank with return on equity, efficiency and asset quality ratios well above local, state and national peer group averages.

Key Manager Statement

"Our proven business strategies produce high performance results consistently in all market conditions. We expect to generate above market average annual growth in earnings and high performance returns on equity for the foreseeable future. We are strong, profitable and have a bright future."

Brad A. Luecke, President & CEO

	2000 Full Year	2001 9 Months
Income (000)	\$14,613	\$12,885
EPS	\$1.35	\$1.19
	20.57%	19.36%
	1.07%	1.11%

Farmer Mac • AGM • Mortgage Securitization

Washington, D.C. • IR Contact: Nancy Corsiglia • 202-872-7700
www.farmermac.com



"Farmer Mac," the Federal Agricultural Mortgage Corporation, is a stockholder-owned instrumentality of the United States, chartered by Congress to provide greater liquidity and lending capacity to rural lenders. Farmer Mac guarantees and purchases agricultural mortgages, providing a reliable source of funding for America's farmers and ranchers at attractive rates. Steadily increasing its guarantee volume each year to the current \$4 billion in guarantees outstanding, the company is still in the early stages of penetrating the \$98 billion agricultural mortgage market. The Farmer Mac guarantee portfolio includes mortgages in 48 states and almost every county produced in the country. AGM ratings have grown at a compound annual rate of 37% since 1998.

Key Manager Statement

"We are pleased to be able to carry out this important Congressional mission for rural America while also providing value to our stockholders."

Henry D. Edelman,
President & CEO

IMPAX Laboratories, Inc. • IPXL • Pharmaceuticals

Hayward, CA • IR Contact: Cornel Spiegler, CFO • 215-289-2220
www.impaxlabs.com



IMPAX Laboratories, Inc. is a technology based specialty pharmaceutical company applying its formulation expertise and drug delivery technology to the development of controlled-release and generics in addition to the development of branded products. The Company has developed seven different proprietary controlled-release delivery technologies that can be utilized to provide a variety of oral dosage forms and release rates. IMPAX offers multi-delivery vehicles: multi-coated pellets, coated pellets, matrix pellets and tablets-coated and uncoated, film coated tablets, multi-layer tablets, rapid dissolving tablets, capsules and oral granules. IMPAX is currently marketing twenty generic products, has thirteen ANDA filings at FDA that address more than \$7.3B in annual U.S. sales; seven of these were made under Paragraph IV of the Hatch-Waxman Amendments. Approximately twenty additional products are in development addressing another \$4B in U.S. product sales. In June 2001, IMPAX entered into a strategic alliance for twelve controlled release products with a subsidiary of TEVA Pharmaceutical Industries Ltd.

Genta Incorporated • GNTA • Biotechnology

Berkeley Heights, NJ • IR Contact: Tara Spiess • 908-286-3980
www.genta.com



Genta Incorporated is a biopharmaceutical company that is focused on the development of novel, "next generation" drugs to treat patients with cancer. Led by a management team that is highly experienced in this sector, Genta's research is anchored by a technical platform in DNA and RNA chemistry (including "antisense" and "decoy" technologies) and several small molecules.

Key Manager Statement

"Genasense™ offers the opportunity to enhance the activity of virtually every type of existing anticancer therapy. Genta is the leader in using antisense drugs to improve the treatment of patients with cancer, and The Company is dedicated to producing a stream of innovative products that attack this disease."

Dr. Raymond P. Warrell, Jr.,
Chairman & CEO.

The Company is conducting a number of late-stage clinical trials with its lead antisense product, Genasense™ in patients with melanoma, myeloma, leukemia and lung cancer. Genta's products address significant unmet medical needs in markets that individually exceed \$1B in annual revenues. The Company intends to be a direct marketer of its products in North America.

Sierra Health Services • SIE • Health Care

Las Vegas, NV • IR Contact: Peter O'Neill • 702-242-7158
www.sierrahealth.com



SIERRA HEALTH SERVICES, INC.

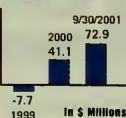
Sierra Health Services is a diversified Las Vegas-based health care services company, with over 55% of the market share in the nation's fastest growing metropolis. In addition to health maintenance organizations and multi-specialty medical groups, Sierra offers health plans and benefits to active and retired military and their dependents in the highly visible northeast corridor. The firm recently announced its exit from the problematic Texas market.

Key Manager Statement

"With continuously improving fundamentals, I expect this company to outperform expectations into 2002 and beyond."

Anthony M. Marlon, M.D. Chairman
& Chief Executive Officer

Operations Cashflow



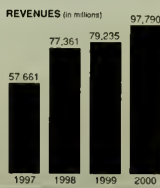
In 2001 Sierra saw its core membership increase by over 20%, cash flow from operations increased over \$100M and total debt reduced nearly 30%. Top-line growth of 15-20% in core operations is expected in 2002. Despite the positive outlook, Sierra still trades at a discount to the market.

Wilson Greatbatch Technologies, Inc. • WGT • Med. Devices

Clarence, N.Y. • IR Contact: Ernest J. Norman, Esq. • 716-759-5689
www.greatbatch.com



Wilson Greatbatch Technologies, Inc. (WGT) is a leading developer and manufacturer of power sources, wet tantalum capacitors and precision engineered components and sub-assemblies used in implantable medical devices as well as for demanding commercial applications. Currently WGT technologies power over 90% of the world's implantable cardiac rhythm management devices such as pacemakers and defibrillators. Additionally WGT's technologies provide the power to meet the rigorous demands of aerospace, oil and gas exploration/extraction and oceanographic applications.



Key Manager Statement

"WGT is a technology leader in every market we serve and our growth will continue to come from successful implementation of business strategies that focus on these markets."

Edward F. Voboril Chairman,
President & CEO

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His Excellency Pongpol Adireksarn

Deputy Prime Minister of the Royal Thai Government Thailand

The Honorable Donald Tsang

Chief Secretary for Administration Government of the Hong Kong Special Administrative Region

The Honorable Fidel Ramos

Former President of the Republic of the Philippines

The Honorable Mickey Kantor

Former Secretary of Commerce and United States Trade Representative, United States

Ronnie Chan

chairman, Hang Lung Development Corporation Hong Kong

Professor Vijay Govindarajan

Earl C. Daum 1924 professor of International Business, Tuck School of Business, Dartmouth College, (rated Top Ten Business School professor by Business Week)

John Pepper

chairman, Procter & Gamble, United States

Kunio Saito

director, Regional Office for Asia and the Pacific International Monetary Fund, Japan

Dr. Michael Spencer

managing director and chief economist Asia Pacific, Deutsche Bank, Hong Kong

P.C. Tan

chairman, ExxonMobil China Investment Company Hong Kong

a dnm Strategies event

creating dialogues not monologues

IT'S TOUGH TO FIND FUND WHIZZES



ROBERT BARKER
businessweek.com

Gregory's
Masters' Select
Funds have
thrived. But
finding the best
managers—and
putting them on
display—has been
a cakewalk

If picking stocks is a random walk down Wall Street, as Princeton economist Burton Malkiel famously put it, then picking mutual funds is an obstacle course through Hell's Kitchen. True, by focusing on low-cost funds and those small enough to trade stocks nimbly, you can tilt the odds in your favor. Yet even the smartest, most determined fund-picker can't escape a host of nasty surprises.

The latest evidence of just how tricky it is to pick the right funds comes from a smart, determined guy named Ken Gregory. A veteran investment adviser and publisher of the *No-Load Fund Analyst* newsletter, Gregory jumped out of bed one night in 1994 with an idea for a fund of his own. "I did a brain dump into the PC," he recalls. Next morning, Gregory awoke with a plan for what today is Masters' Select Funds. Each fund, he imagined, would split its cash among a diverse handful of the best pros—"masters"—that he could find. Yet unlike earlier "funds of funds," each manager would be allowed to pick no more than 15 stocks at a time—their absolute best investment ideas.

Masters' Select Equity opened in December, 1996. If only because innovation in the fund industry usually means starting, say, a telecom fund just as that sector tops out, Gregory's idea was refreshing. Five years later, with benchmark-beating records, it is proving its value (table). "The question with any fund is, 'Are you getting good risk-adjusted performance?'" Russ Kinnel, Morningstar's top fund maven, told me. "These funds have delivered."

Just the same, it has been no cakewalk. Which is why Gregory's experience is worth reviewing. He and his five analysts devote themselves to evaluating managers: putting them through written questionnaires, phone interviews, in-person visits, and portfolio analyses. They debate it all. They do way more, in other

words, than you or I could hope to do. Still, Gregory has faced four crises staying on course.

First, Gregory found he had made a mistake in tapping Jean-Marie Eveillard. Eveillard runs First Eagle SoGen Global with scores of stocks and could not get comfortable picking just 15. "Running a concentrated portfolio was not really my cup of tea," Eveillard told me. So, in 1998, Gregory swapped him for Oakmark Fund's Robert Sanborn. Trouble was that Sanborn, who was under pressure as his style of value investing suffered a deep downturn, quit Oakmark a year and a half later. So Gregory replaced Sanborn with Bill Miller of Legg Mason Value.

PARTING WAYS. In 1997, Gregory opened another fund, the Masters' Select International. One of its five managers, Bruce Bee, died unexpectedly in 1999. Replacing him took some quick work. Just as unexpected was the puzzling trouble with Helen Young Hayes.

Star manager of Janus Overseas and Worldwide funds, Hayes also ran 20% of Gregory's international fund. He said he began a year ago to suspect that she was not focusing on it. Hayes reassured him, and in the fund's annual report he wrote: "We have an extremely high degree of confidence with respect to all of our managers." The report even singled out Hayes for a Q&A.

But by last summer, Hayes seemed to Gregory to pay even less attention to his fund. Gregory approached Hayes, and after some discussion the two agreed she was unable to maintain the same commitment that they both expected when she joined the fund. Hayes left Masters on Sept. 30. She isn't talking, but a Janus spokeswoman said: "This was a mutual decision that was in the best interests of both parties. We have parted ways amicably."

It's true, as Gregory told me, that most of the managers he picked for the Masters' funds have worked out fine. Yet his experience also tells me that even when you know what you're doing, and even when you do it full time, picking a fund manager is devilishly hard. Next time you're tempted to buy anything other than an index fund, remember this—and think again.



the
Masters'
corecard

FUND/SYMBOL	TOTAL RETURN*	BENCHMARK RETURN
MASTERS' SELECT EQUITY/MSEFX	13.1%	9.1%
MASTERS' SELECT INTERNATIONAL/MSILX	10.3	0.6
MASTERS' SELECT VALUE/MSVFX	8.3	3.1

*Average annual, since inception through Nov. 30
Data: Company reports

BusinessWeek online

For barker.online, go to www.businessweek.com/investor/ and click on "Columns"

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PLAY FOR TAKE-TWO?



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Microsoft may be
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ve as Net
es mushroom

Microsoft has stirred the pot in video-game machines with its Xbox. The buzz is that its next move may be the games themselves. Analysts say video games are hot Christmas items this year—fodder for such platforms as Sony's PlayStation 2, Nintendo's GameCube, and Microsoft's Xbox. And obviously, the more games sold, the greater the demand for the hardware. That's why Microsoft has come up with its own offerings, such as Halo. But it has a ways to go to catch up with Electronic Arts, Activision, THQ, or Take-Two Interactive Software.

So Microsoft might bid for one of them. Some pros are betting on Take-Two (TTWO), which sells games for Sony, Nintendo, Apple Computer, and Microsoft machines. A strategist at one investment bank says Take-Two is attractive not only for its products but also because it is the most undervalued: It trades at 14, or 12 times estimated 2002 earnings of \$1.15 a share, vs. Electronic Arts' p-e ratio of 91, Activision's 30, and THQ's 28. "The video-game business is driven by hits," says Arvind Bhatia of sws Securities, and Take-Two "has big hits." Its Grand Theft Auto III has been one of the top-sellers since its release on Oct. 22. Canvassing 40 outlets, including Best Buy and Wal-Mart Stores, Bhatia notes retailers report the game "in very high demand." He rates the stock a buy. Thomas Andrews of GKM Research says Take-Two is a "compelling investment due to its solid line-up." Take-Two President Paul Eibeler, a consultant to Microsoft when it was developing Xbox, wouldn't say if Microsoft was eyeing Take-Two. But he says mergers will happen—now that Microsoft is a big player. Microsoft couldn't be reached for comment.

DRILLING HARD AT GLOBALSANTAFE

In this nervous market, Joan Lappin, president of Gramercy Capital Management, sticks with companies with "excellent" balance sheets, compelling positions in their markets, and stocks that are near their lows. All that she finds in GlobalSantaFe (GSF), the product of a merger between Global Marine and Santa Fe International. The union made GlobalSantaFe the world's second-largest oil driller, which now owns and operates a fleet of 59 mobile offshore rigs and 31 on land. Transocean Sedco Forex, next in size to Global, is trading at 20.5 times next year's estimated earnings, notes Lap-

pin. Transocean has debt of \$4.9 billion and a market cap of \$9 billion. Before the merger, Santa Fe had no debt, and Global Marine had some \$1 billion. Based on Lappin's 2002 earnings estimate of \$2.25 a share, GlobalSantaFe, trading at 25, has a p-e of 11, with a market value of \$5.8 billion. Lappin thinks GlobalSantaFe also deserves a p-e of 20, implying a price of 45. With Global now a bigger player and getting more Street attention, Lappin thinks its stock should move higher. Says Allen Brooks, of CIBC World markets: "Global is the most undervalued offshore driller we cover." He rates it a "strong buy."



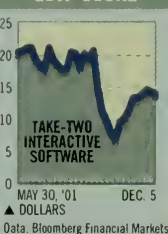
LAPPIN: High on GlobalSantaFe

REGISTER.COM: ITS DOMAIN EXPANDS

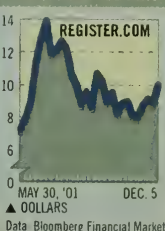
Register.com (RCOM), a dot-com survivor, has fallen hard: Its stock dived from 100 in early 2000 to 10 on Dec. 5. But it's making money and has strong growth prospects. So says Jonathan Cohen of JHC Capital Management in Greenwich, Conn., who thinks the stock is a good play on the growth of the Net. Also, he figures Register.com is one of the few attractive takeover targets around. Its business is registering Web domain names—those ending, for example, in .com, .net, and .org. In 2002, says Cohen, Register.com will get a big boost when new top-level domains, in which it owns a controlling stake, are opened—such as .pro, available to doctors, lawyers, accountants, and the like. Cohen says encryption, verification, and authentication will be required for the registrations, thus swelling Register.com's revenues.

Companies that might find Register.com attractive, says Cohen, include Yahoo!, which would benefit from Register.com's strong cash position and revenues. "Register.com's balance sheet remains solid," says Todd Weller, an analyst at Legg Mason Wood Walker, who rates the stock a strong buy. He sees earnings of 50¢ a share in 2002. The company has cash of \$180 million, or \$5 a share. There is limited downside risk at the stock's current price, he adds. Register.com has only 10% of the market (compared with 80% for VeriSign), but it has a 20% share of the high-end corporate domain business. Yahoo and Register.com declined comment.

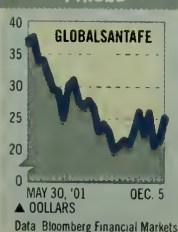
AN ATTRACTIVELY LOW SCORE



POUNDED IN THE DOT.COM SLUMP



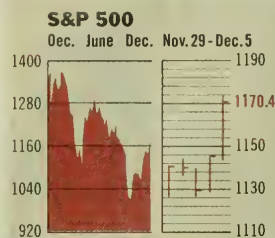
ROCK-BOTTOM PRICES



BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks



COMMENTARY

Stocks soared on Dec. 5 after the National Association of Purchasing Management reported better-than-expected growth in services. The move topped off a week in which the Dow Jones Industrials and the S&P 500 rose 4.1% and 3.7%, respectively. But the real star was the Nasdaq, up 8.4%, on optimism that chip prices have bottomed and demand is growing.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Dec. 5	Week	Year to date	Last 12 months
S&P 500	1170.4	3.7	-11.4	-13.4
Dow Jones Industrials	10,114.3	4.1	-6.2	-5.2
Nasdaq Composite	2046.8	8.4	-17.1	-29.2
S&P MidCap 400	503.9	4.8	-2.5	-0.6
S&P SmallCap 600	226.9	6.3	3.3	8.9
Wilshire 5000	10,834.5	3.9	-11.0	-14.1

SECTORS

BusinessWeek 50*	754.9	3.9	-22.2	-30.2
BusinessWeek Info Tech 100**	440.3	8.5	-22.2	-38.9
S&P/BARRA Growth	608.6	3.6	-11.5	-20.5
S&P/BARRA Value	561.2	3.8	-11.8	-10.0
S&P Energy	813.2	5.8	-12.7	-8.8
S&P Financials	146.6	1.7	-11.0	-6.7
S&P REIT	93.4	1.9	6.2	9.6
S&P Transportation	694.4	4.0	-0.5	-0.3
S&P Utilities	234.0	1.0	-33.3	-27.4
GSTL Internet	106.7	7.1	-41.2	-55.9
PSE Technology	724.7	8.6	-11.0	-19.7

*Mar. 19, 1999=1000

**Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Metals	26.0	70.1
Photography/Imaging	22.1	61.6
Semiconductors	20.9	55.2
Commercial Services	20.8	41.4
Homebuilding	20.8	41.3

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Pacific/Asia ex-Japan	12.0	Precious Metals	21.8
Diversified Emerging Mkts.	8.4	Small-cap Value	15.3
Technology	7.9	Real Estate	11.8
Communications	5.5	Mid-cap Value	8.9
Laggards		Laggards	
Japan	-3.9	Technology	-43.1
Utilities	-1.4	Communications	-40.9
Precious Metals	-0.3	Japan	-33.5
International Hybrid	0.6	Large-cap Growth	-26.1

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
COC Nvest Bullseye B	34.7	Schroder Capital Ultra Inv.	82.4
iShares MSCI S. Korea Indx.	21.2	CGM Focus	62.4
Black Oak Emerging Tech.	19.6	Pilgrim Russia A	52.3
Matthews Korea	18.9	Potomac Internet Short	52.0
Laggards		Laggards	
ProFunds UltraShort OTC	-15.2	ProFunds UltraOTC Inv.	-78.3
Potomac Internet Short	-14.4	Merrill Lynch Focus 20 B	-73.9
O'Higgins	-8.7	Van Wagoner Mid Cap Gr.	-70.4
Prudent Bear	-8.3	Van Wagoner Post Venture	-70.4

Data: Standard & Poor's

GLOBAL MARKETS

	Dec. 5	Week
S&P Euro Plus (U.S. Dollar)	1087.3	4.6
London (FT-SE 100)	5333.5	2.5
Paris (CAC 40)	4677.6	5.2
Frankfurt (DAX)	5262.8	7.1
Tokyo (NIKKEI 225)	10,713.8	0.8
Hong Kong (Hang Seng)	11,678.4	5.5
Toronto (TSE 300)	7620.2	3.6
Mexico City (IPC)	6099.3	4.3

FUNDAMENTALS

	Dec. 4	Wk.
S&P 500 Dividend Yield	1.36%	1.36%
S&P 500 P/E Ratio (Trailing 12 mos.)	46.3	46.3
S&P 500 P/E Ratio (Next 12 mos.)*	21.9	21.9
First Call Earnings Revision*	-1.80%	-2.3%

*First Call Corp.

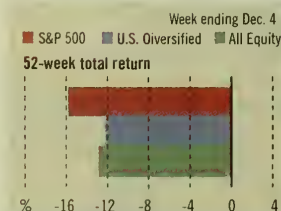
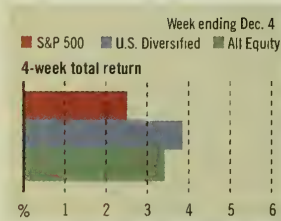
TECHNICAL INDICATORS

	Dec. 4	Wk.
S&P 500 200-day average	1177.1	1181.1
Stocks above 200-day average	51.0%	49.4%
Options: Put/call ratio	0.72	0.68
Insiders: Vickers Sell/buy ratio	1.12	1.04

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %
Natural Gas	-15.0	Communications
Gold Mining	-7.5	Natural Gas
Tobacco	-4.1	Instrumentation
Soft Drinks	-2.6	Defense Electron
Electric Companies	-2.5	Computer System

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES	Dec. 5	Week
MONEY MARKET FUNDS	2.11%	2.18%
90-DAY TREASURY BILLS	1.76	1.83
2-YEAR TREASURY NOTES	3.06	3.05
10-YEAR TREASURY NOTES	4.89	4.92
30-YEAR TREASURY BONDS	5.36	5.35
30-YEAR FIXED MORTGAGE†	6.88	7.01

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.28%
TAXABLE EQUIVALENT	6.20
INSURED REVENUE BONDS	4.49
TAXABLE EQUIVALENT	6.51

THE WEEK AHEAD

FOMC MEETING Tuesday, Dec. 11, 9 a.m. EST ► The Federal Reserve's Open Market Committee will meet to set monetary policy. Over two-thirds of the economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies, forecast a quarter-point cut in the federal funds rate, to 1.75%. The remainder of economists surveyed forecast no change.

RETAIL SALES Thursday, Dec. 13, 8:30 a.m. EST ► Retail sales probably fell 1.5% in November, due to a drop-off in

auto sales after a record October. Excluding autos, sales were likely up 0.3%.

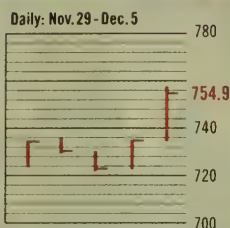
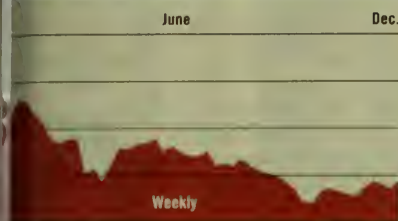
PRODUCER PRICE INDEX Thursday, Dec. 13, 8:30 a.m. EST ► Producer prices of finished goods in October likely fell 0.2%. Core prices, excluding food and energy, are expected to have risen 0.1%.

BUSINESS INVENTORIES Friday, Dec. 14, 8:30 a.m. EST ► Inventories in October are projected to have fallen 0.3%, after dropping 0.5% in September.

CONSUMER PRICE INDEX Friday, Dec. 14, 8:30 a.m. EST ► Consumer prices for goods and services were likely up in November, after slipping 0.3% in October. Core prices, excluding the volatile food and energy components, probably increased 0.2%, after up 0.2% in October.

INDUSTRIAL PRODUCTION Friday, Dec. 14, 9:15 a.m. EST ► Factory output rose for the 10th time this year, by 0.1% in November, after a 1.1% drop in October.

BusinessWeek Fifty

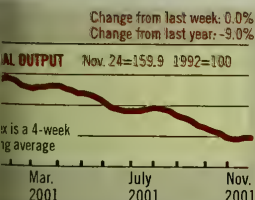


upped 3.9% for the week. Leading the charge were chipmakers Micron Technology, up 23.7%, Al-
nd Xilinx, 23.1%. Semiconductor equipment manufacturers Teradyne and Applied Materials climbed
1.6%, respectively. Dynegy declined another 21.2%, and Calpine fell 4.4% this week as investors
y stocks in the wake of the Enron bankruptcy proceedings.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	2.4	9.5	26	Verizon Communications	0.6	-0.6
Petroleum	6.3	-13.0	27	Citigroup	2.5	0.7
	-4.4	-54.7	28	Sun Microsystems	10.7	-27.4
	-21.2	-38.2	29	Merck	1.4	-16.9
Materials	14.6	1.3	30	El Paso	-1.5	-37.7
Financial	-3.8	-93.9	31	Altera	23.6	6.3
al Petroleum	9.1	12.0	32	Marsh & McLennan	2.1	3.7
	8.1	-17.4	33	Household International	1.1	4.5
ee	5.5	-15.7	34	ChevronTexaco	3.5	0.8
	8.9	-28.1	35	SBC Communications	2.0	-15.7
Brothers Holdings	2.6	-0.1	36	Mercury Interactive	15.2	-39.4
	7.5	-58.2	37	AOL Time Warner	0.9	-18.6
	5.7	-68.9	38	Washington Mutual	-2.9	-8.1
laboratories	-0.7	4.9	39	General Dynamics	-0.4	22.0
ton Financial	0.9	-8.3	40	Comcast	4.2	-7.5
technology	23.7	-7.9	41	Morgan Stanley Dean Witter	3.1	-12.2
	23.1	2.2	42	Tellabs	12.3	-61.6
Hess	6.5	-16.8	43	Exxon Mobil	4.8	-4.5
ergy	2.7	-10.1	44	Scientific-Atlanta	17.3	-33.7
communications	4.0	-55.1	45	U.S. Bancorp	5.4	-16.6
ne Financial	-1.3	-8.0	46	Paychex	12.8	-0.2
Petroleum	7.4	9.6	47	Merrill Lynch	7.4	-12.5
ervices	15.9	14.7	48	Bed Bath & Beyond	6.8	37.8
ources	13.8	-10.4	49	Texas Instruments	8.0	3.4
Health	-0.1	1.2	50	Teradyne	15.5	3.6

Production Index



on index remained unchanged over the
week ended Nov. 24. Before calculation of
moving average, the index fell to 158.8.
Lumber and rail-freight traffic declined
with coal and electric power also slip-
trucks, steel, and crude-oil refining were all
week. Through November, the production
lower, to 159.9, from 160.1 in October.

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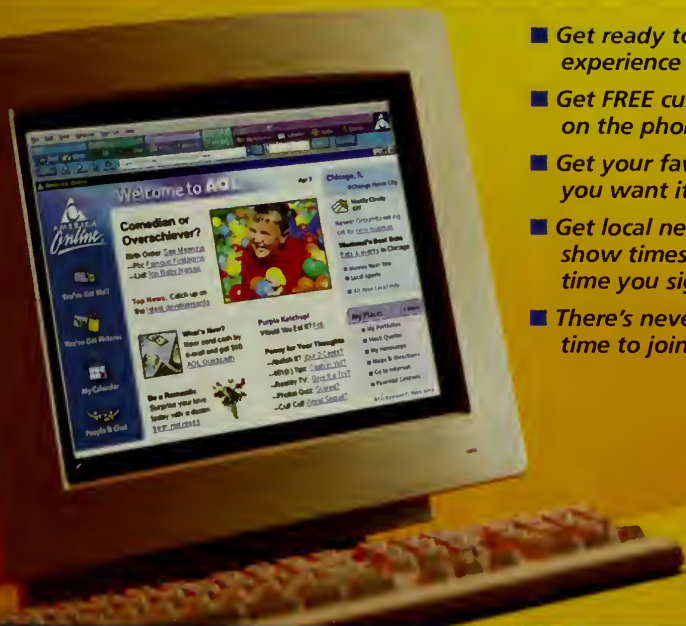
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ENRON: LET US COUNT THE CULPRITS

Enron Corp.'s bankruptcy is a disaster of epic proportions by any measure—the height from which it fell, the speed with which it has unraveled, and the pain it has inflicted on investors, employees, and creditors. Virtually all the checks and balances designed to prevent this kind of financial meltdown failed. Unless remedied, this could undermine public trust, the capital markets, and the nation's entire equity culture. Even now, no one really knows what liabilities are buried inside dozens of partnerships or the role ex-CEO Jeffrey Skilling played in creating a byzantine system of off-balance-sheet operations. A culture of secrecy and a remarkable lack of transparency prevented any realistic assessment of the company's financial risk. Nothing less than an overhaul of the auditing profession is now required to police accounting standards. Wall Street, mutual funds, and the business press would also do well to rethink why each, in its own way, celebrated what is now revealed to be an arrogant, duplicitous company managed in a dangerous manner (page 30).

What is increasingly clear is that Skilling, a former McKinsey & Co. consultant and Harvard Business School grad, tried to craft Enron as a new kind of virtual trading giant, operating outside the scrutiny of investors and regulators. Enron's numerous partnerships were shrouded in secrecy, tucked away off the balance sheet. They were used to shift debt and assets off the books while inflating earnings. The chief financial officer ran and partly owned two partnerships, a clear conflict of interest. Enron leveraged itself without a reality check by any outsider.

ASLEEP. Hardly anyone inside the company was urging caution, certainly not chairman Ken Lay. The independent auditing committee on the board of directors was clearly asleep. Given Enron's arcane financial engineering, the committee probably relied on Arthur Andersen, the auditor, for information. But Andersen didn't blow any whistles. No surprise there. It made more money selling consulting services to Enron last year than it did auditing the company. Criticizing Enron's books might have jeopardized consulting work. Similar conflicts of interest stopped Wall Street analysts from pulling the plug on Enron. Even as Enron slid toward bankruptcy, "buy" recommendations were being issued by analysts whose firms were doing investment-banking business with the company, or were hoping to.

Did anyone really know what was going on inside Enron? The rating agencies, Moody's Investor Service and Standard & Poor's, presumably had better access than average investors, but neither downgraded Enron's credit rating to below investment grade until the bitter end. The rating agencies argue that had they downgraded Enron sooner, they would have simply pushed the company into bankruptcy earlier. Here's a flash: So what? Moody's and S&P have one basic job—assessing

risk for investors. If they couldn't penetrate Enron's complex financial engineering, the rating agencies should have said so.

The business press, including *BusinessWeek*, did not. It celebrated Skilling's vision of Enron as a virtual company that could securitize anything and trade it anywhere. The press blithely accepted Enron as the epitome of a new, deregulation corporate model when it should have been more aggressive in probing the company's opaque partnerships, off balance sheet maneuvers, and soaring leverage. **TRAGIC.** Enron's fall is made all the more tragic because of the pain inflicted on its thousands of employees. Not only many losing their jobs, but some 12,000 are also losing their retirement savings. In perhaps its most egregious management error, employees mostly held Enron stock in their 401(k)s, yet the company prevented them from selling until they reached the age of 54. People could only watch their stock plummeted from \$89 to a dollar. Diversification, particularly in retirement accounts, is the cardinal rule in managing risk. Enron broke that rule, as have other companies.

Enron's tale is a clarifying event. It reveals key weaknesses in the financial system that must be corrected as the U.S. moves forward in the 21st century. If America is to have an equity culture in which individuals invest in stocks and provide the capital for fast economic growth, the market must be able to correctly value companies. This requires making financial data readily available and easily comprehensible.

To restore public confidence, several steps should be taken. After accounting disclosure at MicroStrategy, Cendant, Lucent, and Waste Management, it is clear that

regulation is not working. Conflicts of interest within auditing firms remain widespread. Investors can ignore analysts on TV who work for investment firms. But someone must play the role of the honest watchdog. Unless the Big Four auditing firms clean up their act, they will wind up under a federally chartered oversight body. It is equally clear that current standard accounting rules aren't sufficient. The holes allowed Enron to fool everyone, making a mockery of public disclosure.

Regulators should also insist that corporations give employees choice in their 401(k)s. Some 30% of assets held in 1.5 million 401(k) plans are in the stock of the company sponsoring the plan. This lack of diversification puts too many people at risk.

In the end, the Enron story is about a secretive corporate culture that failed in its primary business mission: to manage risk. Had the Federal Reserve and other central banks not flooded the global economy with liquidity in recent months, Enron's collapse could have posed a deep threat to the financial markets. It's past time to fix the system.



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CARLY'S LAST STAND?

The inside story of the infighting at Hewlett-Packard

BY PETER BURROWS

PAGE 62

Keyword: BW

A man with dark hair, wearing a white lab coat, stands in a brightly lit laboratory. He is looking slightly to his right with a calm expression. His arms are crossed. The background is a soft-focus view of laboratory equipment and windows.

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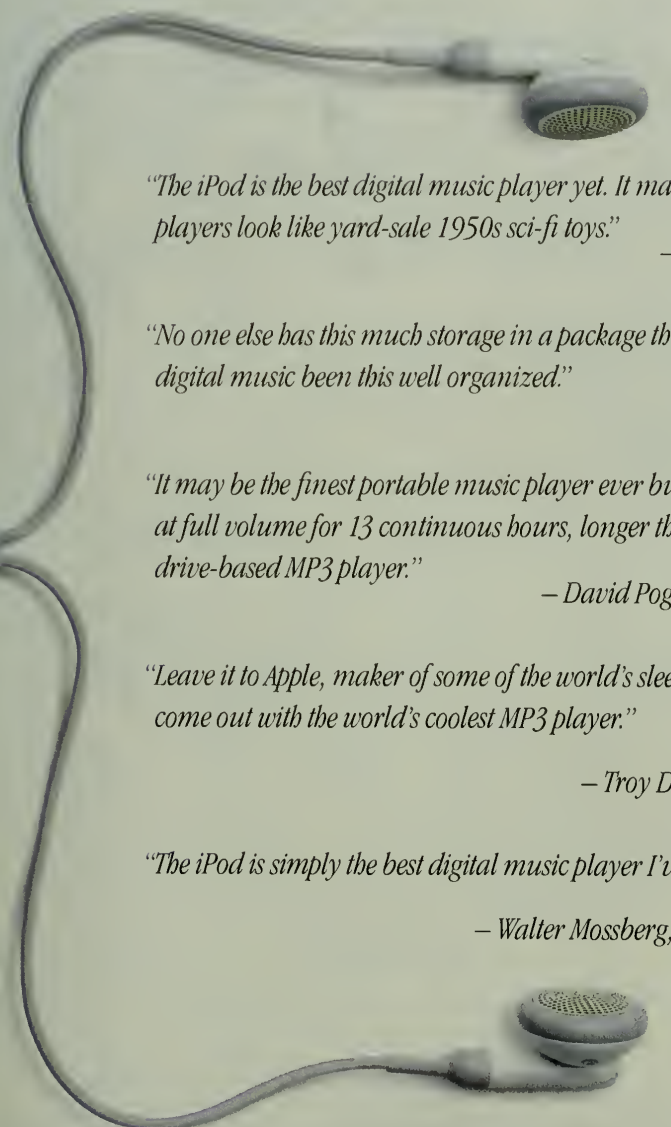
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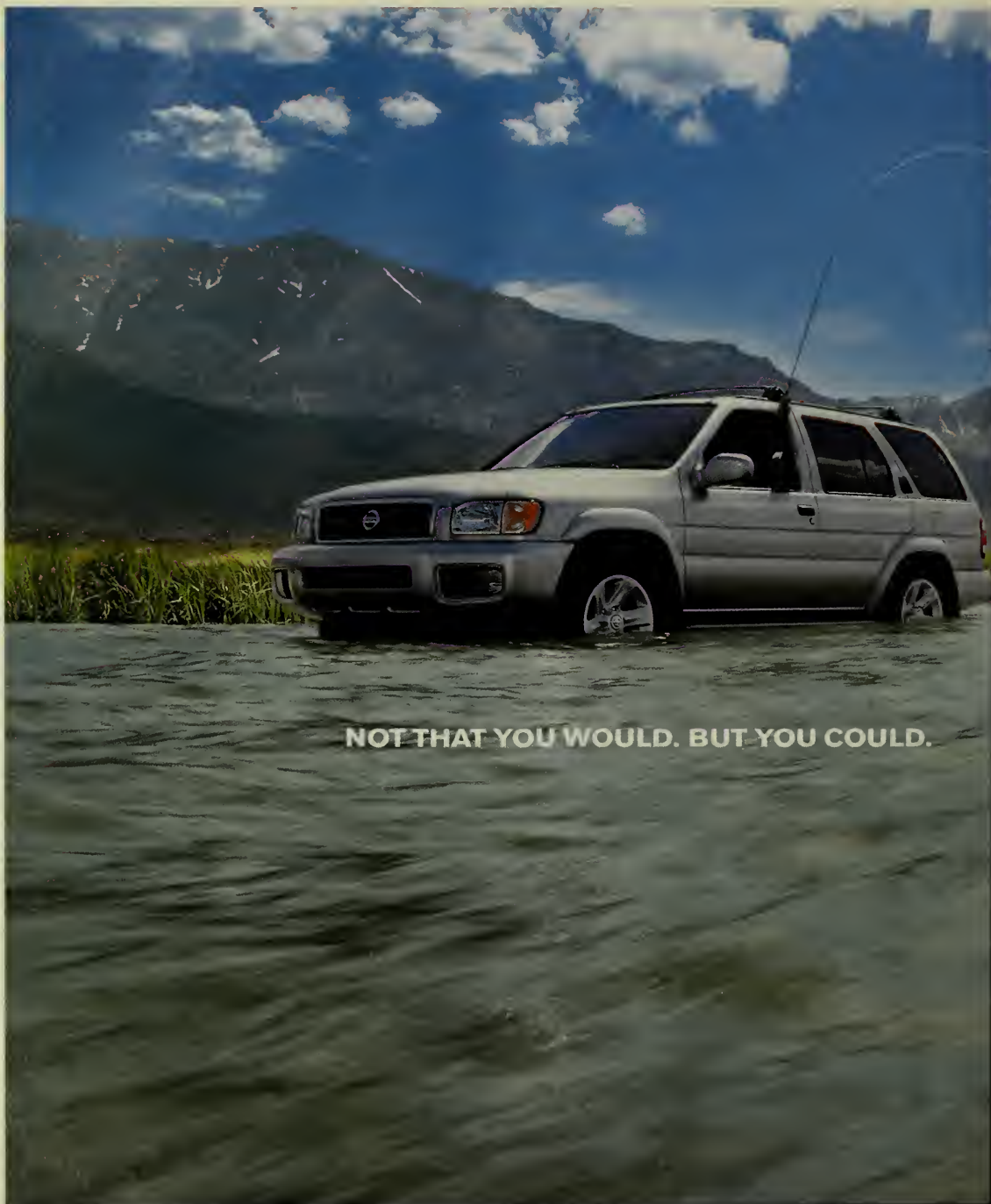
— David Pogue, *The New York Times*

"Leave it to Apple, maker of some of the world's sleekest computers, to come out with the world's coolest MP3 player."

— Troy Dreier, *pcmagazine.com*

"The iPod is simply the best digital music player I've seen."

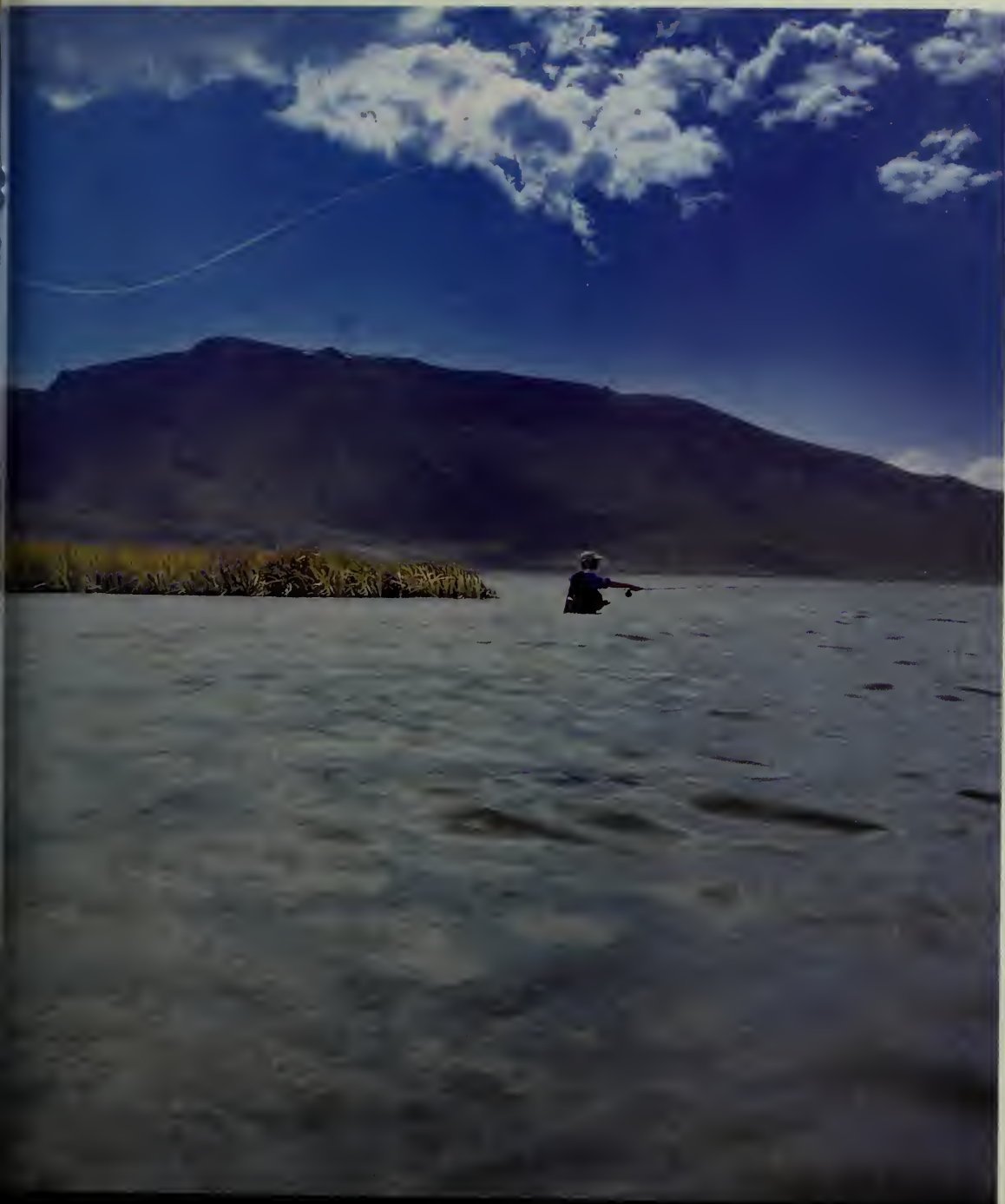
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BusinessWeek

DECEMBER 24, 2001

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ROUGH ACCOUNTING

Enron's collapse also taken its toll

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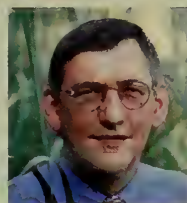


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Rolling On?

Zero-percent financing is helping GM turn 2001 into a banner year. For 2002, though, its prospects—and share price—will ride more with the overall U.S. economy



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Moveable Feast: Michel Roux, the developer of Absolut's striking ads, is trying again with several new spirits

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Commentary: Slackers often get months of warning and help before being sacked, while those downsized during cutbacks usually just get a goodbye



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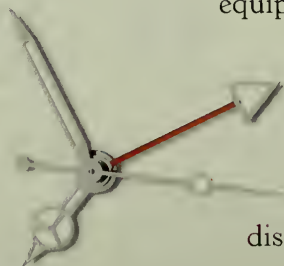
A conversation with Jack Welch

Creative strategies for charitable giving



Even the most savvy travelers can use a helping hand.

For frequent international travelers, it can be more than a trifle challenging trying to juggle schedules in two different time zones. For these highly mobile executives, there's the Rolex GMT-Master II. This ruggedly handsome and dependable timepiece is



equipped with a supplementary 24-hour hand that enables a traveler to determine at a glance the time in a second time zone. This makes international travel a little less disorienting, and shows that for weary travelers four hands can be just the ticket.

For more information on the Rolex Oyster Perpetual GMT-Master II in stainless steel with matching Oysterlock bracelet. For the name and location of an Official Rolex Dealer near you, please call 1-800-36ROLEX. Rolex, the Rolex crown logo, Oyster Perpetual, GMT-Master II and Oysterlock are trademarks. www.rolex.com



ROLEX

Up Front

EDITED BY SHERIDAN PRASSO

AFTER 9/11

CRACKING DOWN ON FAKE IDS

THE FEDS MAY BE DANGLING green cards as rewards in their pursuit of terrorists, but the states are starting to make it tougher for immigrants to obtain a more basic



TOUGHER: North Carolina DMV

document: a driver's license.

After September 11, at least six states cracked down on lenient licensing procedures, and those measures are taking effect. North Carolina started requiring Social Security numbers and proof of residency as of Nov. 1 to combat a massive fake driver's license network. State

officials found 350,000 licenses issued with bogus 999-99-9999 Social Security numbers, and "driver's license" shuttle buses running to Charlotte from at least four Southern states. "A driver's license opens the door to a lot of different benefits," says North Carolina state Representative Larry Justus (R.), who introduced the legislation.

In September, Wisconsin stopped accepting a common immigration document as proof of residency. Virginia will no longer accept personal sworn statements of identity—used by several September 11 hijackers to obtain Virginia IDs. In New Jersey, licenses now expire at the same time

as visas; the state is also considering tamperproof digital photos and bar codes. Beginning on Dec. 1, non-citizens in Florida could get a 30-day driver's permit, but licenses require background checks. National standards may be next.

Brian Grow

THE LIST HOT HOLIDAY TOYS

Hooray for Hollywood. Movies and television shows are generating must-have toys this holiday season.



BOB THE BUILDER Hasbro, \$34.99	Talking toy trucks, based on a TV show
HOGWARTS CASTLE Lego, \$89.99	Lets kids build Harry Potter's school
JAM 'N GLAM BARBIE Mattel, \$12.99	Rockstar Barbie in silver lamé pants and bare midriff
MONSTERS, INC. FIGURES Hasbro/Thinkway, \$32.99	Monsters growl and repeat speech from the movie
XBOX, GAMECUBE CONSOLES Microsoft, Nintendo \$299, \$199	Videogame systems

Data: Toys 'R' Us

TALK SHOW "At the top of the list for us always are... the economics of the deal itself. Does this deal make sense?"

—Patrick McGurn of Institutional Shareholder Services, adviser to many Compag and HP investors voting on the proposed merger.

EURO PHOBIA

STRESS, ITALIAN STYLE

AS IF RECESSION AND THREATS of terrorism weren't enough to pop stress barometers, Italy's bank tellers have another reason to worry. Europe's new currency will be introduced on Jan. 1, and the tellers fear an epidemic of what's being dubbed "euro stress." French bank tellers are getting anxious as well (page 49).

As a remedy, Italy's bank unions want the government to pay \$400 million to the country's 320,000 tellers—or about \$1,000, plus benefits, per person. "These people



face a lot of problems," says Edgardo Iozia, national secretary of the moderate U union. "There are physical risks because of robbery, professional risks because of counterfeit bills, and the pressures of answering many questions from confused customers."

Polls show Italian stress among Europe's least prepared for the euro's debut 40% of citizens say as of dread Jan. 1, and 70% Italy's elderly fear being shortchanged by rounded conversions.

Unions point to prevent "Bankers got \$100 million for the millennium age for just one day," says Iozia. "His is a month of stress." Monica Larni

NEW BILL
Arrived in lira

CAR TALK

WILL LED ZEPPELIN SELL LEAD SLEDS?

"BEEN A LONG TIME SINCE I rock and rolled." That 1971 Led Zeppelin line is a pretty good description of Cadillac. Fittingly, General Motors' luxury division will use the tune to pump up its new ad campaign early next year.

Cadillac could use some adrenaline. It's trying to make a comeback after losing the lead in luxury-car sales to imports. The first of five ads will likely feature the \$30,000 CTS, an edgy-styled sedan going on sale in January. Cadillac's ad agency,

D'Arcy Masius Benton & Bowles, hopes to strike chord with boomers who rocked to Zeppelin, but not buy imported luxury cars like Lexus, Mercedes-Benz, or BMW. Says D'Arcy's Cadillac account head, Joe Gagliardi, "There will be a lot of action in the new advertising."

That's a shift from GM's recent ads, which focused on safety features such as vehicle stability system and satellite-based navigation.



ROCK THERAPY: Led Zep

So some excitement is sorely needed. The question is: Can a bunch of British rockers—who have put out a new album since 1988—reignite the passion for Cadillac?

David Welch

Both can plot a course to get you where you're going.
But only one can be your personal investment manager.

*Captain Finnel
Chicago, IL*



*David H. Bugen, CFP
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Up Front

THE QUIZ

Yes, there *was* news before September 11. Take our quiz and find out how much you remember. There's no prize, but just think how smart you'll feel if you get all the answers right.



1 Which was the second-biggest bankruptcy filing (after Enron) of 2001?

- a. Federal-Mogul
- b. Pacific Gas & Electric
- c. Reliance Group
- d. FINOVA Group



2 Which of these has not filed for bankruptcy?

- a. Wheeling-Pittsburgh Steel
- b. LTV
- c. Bethlehem Steel
- d. National Steel

3 About what percentage of U.S. households has broadband Internet access?

- a. 5%
- b. 10%
- c. 15%
- d. 20%

4 At the time of California's energy crisis, about how many states were planning to deregulate their retail electricity sales?

- a. 25
- b. 15
- c. 10
- d. 5



5 Which two companies were both winners in the 2001 Massachusetts Institute of Technology's Sloan eBusiness Awards?

- a. Palm and Lucent
- b. GE and eBay
- c. Enron and Napster
- d. Palm and Amazon.com

6 Former President Bill Clinton received a \$10 million advance for his memoirs from which publishing company?

- a. Harper Collins
- b. Knopf
- c. Simon & Schuster
- d. Farrar, Straus & Giroux

7 W. James McNerney Jr. now heads which company after getting passed over for the top job at General Electric?

- a. 3M
- b. Home Depot
- c. Conesco
- d. Honeywell International
- e. Lucent Technologies

8 Boeing relocated its headquarters from Seattle to which city in 2001:

- a. Atlanta
- b. Chicago
- c. Dallas
- d. Denver



9 Which drug was approved this year and is almost guaranteed to be a blockbuster?

- a. Cialis, for erectile dysfunction
- b. Gleevec, to treat leukemia
- c. Vioxx, a painkiller
- d. Xigris, to treat sepsis

10 Enron did not plan an online exchange for which industry?

- a. container shipping
- b. lumber
- c. media
- d. broadband access



11 About 13 million square feet of office space were

lost when the World Trade Center collapsed. That's about equal to the total amount of office space in downtown:

- a. New Haven
- b. Houston
- c. Atlanta
- d. Fort Worth

12 Which of these airlines did not turn a profit in the quarter ended Sept. 30?

- a. Alaska Air
- b. Frontier
- c. Midwest Express
- d. Southwest

13 Which of these countries does not share a border with Afghanistan?

- a. China
- b. Turkmenistan
- c. Iran
- d. Kazakhstan



14 Which two aircraft have been used as surveillance drones in Afghanistan by the U.S. military?

- a. Predator
- b. Raptor
- c. Global Hawk
- d. Canard Rotor/Wing

15 Which of these '60s-era cars is being reintroduced for 2002?

- a. Mini Cooper
- b. MG Midget
- c. Triumph Spitfire
- d. Austin Healy 3000

16 True or False?

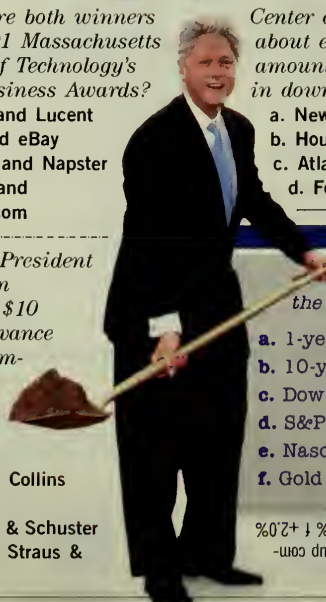
a) A D.C. Federal Appeals Court has ruled that Microsoft is a monopoly.

b) Under the proposed settlement, the Justice Dept.'s antitrust cops will begin patrolling the hallways of Microsoft's Redmond (Wash.) campus.

c) The U.S. Supreme Court has agreed to review the Microsoft case.

d) Mario Monti, the European Union's top antitrust enforcer, is considering breaking up Microsoft.

e) The Microsoft case is nearing its resolution.



NUMBERS GAME

17 Match the investment or index with the year-to-date return, through November

- a. 1-year Treasuries -12%
- b. 10-year Treasuries +4%
- c. Dow -2%
- d. S&P 500 +6%
- e. Nasdaq -7%
- f. Gold +2%

Data: Bianco Research, Bloomberg Financial Markets

Polls, surveys, and other items for consideration in this section should be sent to upfront@businessweek.com

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way from being over, and for you to suggest otherwise is misleading.

Steve Roberts
Dittisham, England

WHAT KIND OF ECONOMIC AID DOES AFGHANISTAN NEED?

The Marshall Plan, which played a leading role in Western Europe's post-war reconstruction, is too often, too loosely evoked in advocacy of some kind of aid program ("Winning the peace," Cover Story, Dec. 3). Such proposals usually neglect distinctive features of the Marshall Plan that should limit the term's applicability. It was a regional strategy consisting of more than bilateral aid programs. It started with a speech by the U.S. Secretary of State. A Marshall Plan-style initiative (this time by many advanced countries and various international agencies) is needed concerning Afghanistan, but projecting a regional development strategy involving not just Central Asia, but the whole Middle East.

David J. Steinberg
Alexandria, Va.

Editor's note: The writer worked in administering the Marshall Plan in Washington and London.

Business must step up to the plate in the reconstruction of Afghanistan and the recovery of the global economy. But continued stability and improvement require substantial foreign direct investment by corporations. How much is investment required? A quick calculation based on U.S. data indicates a requirement of \$13 billion a year for Afghanistan—from foreign investors initially, but rapidly developed internally. For all of the countries below the median gross domestic product per capita, the required foreign direct investment to close the gap is \$1 trillion per year—about 3.5% of global GDP.

Randal Haithecock
Durham, N.C.

LET'S GIVE SCOTT MCNEALY A BREAK

I was surprised to read the attacks on Scott McNealy of Sun Microsystems Inc. ("What mankind needs: Less whining from Scott McNealy," Readers Report, Dec. 10, responding to "Face-off," Cover Story, Nov. 19). McNealy is a progressive and compassionate man. His main failing, like that of Steve Jobs of Apple Computer Inc., is his inability to think outside of the hardware box.

The harsh truth is that computer

manufacturers have more in common with Maytag than with Microsoft. Microsoft Corp.'s monopoly is certainly not based on quality products. However, like Andrew Carnegie, William H. Gates III alone seems to understand "it's"—It's the software, stupid!

I was encouraged by McNealy's decision to refocus Sun's talent on software. Sun Microsystems Inc. and Apple Computer Inc. are both capable of grabbing a major share of Microsoft's operating systems market. To get that share, they must stop expending talent trying to build a better washing machine.

David L. Hagan
Pismo Beach, Calif.

REWARD THE TEAM, NOT THE STARS

Louis Lavelle's commentary put forward the old idea that vast pay differentials between "stars" and "deadwood" will lead to success ("Thinking beyond the one-size-fits-all pay cut," News: Analysis & Commentary, Dec. 3). Hundreds of organizational-effectiveness studies have shown that the greatest productivity in the organization comes not from the manager-identified "stars" but from teams where a collaborative culture keeps the focus on team success and team production. Reward teams that bring in the results with high quality, on time and on budget, and you will build business success. Provide an incentive for infighting, and you destroy the basis for corporate success.

Victoria Marney-Petix
Fremont, Calif.

Jack Welch is a hands-on manager, but his Darwinian selection of the fittest (and the rest be damned) is contrary to "good management." Performance assessment is an art, the object of which has less to do with monetary reward and much more to do with understanding objectives, choosing the right metrics for evaluation, and explaining to people why they merit a raise or not. It is one component of the art of management, and there are others equally important: coaching, recognition of accomplishment (other than monetary), understanding the capabilities of staff personnel, knowing their competencies (and the obverse), etc. It is a very mixed bag of managerial capabilities that makes teams work well together. The Welch mantra is just one tiny component. Do just that one thing, and managers will inevitably fail.

Tony Perla
Aix-en-Provence, France

THE BIG BOARD CAN STAND SOME COMPETITION

We agree with Jeffrey E. Garten of the New York Stock Exchange performing an important function in the marketplace ("The big board shouldn't be just another company," Economic Viewpoint, Nov. 12). Nevertheless, government protection of any market or exchange above others flies in the face of the competitive free market system that the U.S. promotes worldwide.

The floor of the NYSE is a thorough commercial enterprise. It is not, for example, like the New York Public Library. Anointing the NYSE because of its entrenched position would be a policy. It would insulate the Big Board from the only force that drives it to improve competition.

Gerald D. Puterbaugh
Chairman and CEO
Archipelago Group
Chicago

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Mail safety: What every concerned business executive should know.

Your employees, your customers, your revenue could all be affected. What can you do to lessen the impact?

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JOHN MAYNARD KEYNES
Fighting for Freedom, 1937-1946
 By Robert Skidelsky
 Viking • 580pp • \$34.95

KEYNES: THE ECONOMIST IN WINTER

In 1936, at the height of his intellectual powers, John Maynard Keynes was confident in the ability of economists, and himself in particular, to influence world events. "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood," wrote Keynes. "Indeed the world is ruled by little else."

But even the most brilliant of economists are sometimes at the mercy of practical forces they cannot control. This is the central theme of the third and last volume of Robert Skidelsky's epic biography: *John Maynard Keynes: Fighting for Freedom, 1937-1946*. Skidelsky gives a powerfully evocative picture of "the most famous, and controversial, economist in the world" trying to shape the postwar global economy and fighting to retain Britain's role as a great power—and falling short on both counts.

The previous volume of Skidelsky's trilogy, subtitled *The Economist as Savior, 1920-1937*, showed Keynes ascendant, developing the ideas of Keynesian economics that were to dominate the later, postwar era. But the new book starts on a different note, with Keynes, age 54, entering a sanatorium in 1937, battling subacute bacterial endocarditis, which damaged his heart valves and ended up killing him nine years later. The sense of a grueling, uphill struggle runs through the book, with Keynes serving a British government that rightly cared more about the war than the economy.

Indeed, Skidelsky points out that Keynes received only a single mention in Winston Churchill's five-volume history of World War II, even though Churchill and Keynes regularly dined together. Yet Keynes played an absolutely central part in Britain's war effort. In his role as unpaid adviser to the British Treasury, Keynes dominated

economic policymaking. He "was, in fact, the Churchill of war finance and post-war financial planning," writes Skidelsky. And he had a larger-than-life quality that awed even accomplished peers. "I often find myself thinking that Keynes must be one of the most remarkable men that have ever lived," wrote one colleague. He had "a unique unearthly quality of which one can only say that it is pure genius."

What comes across most clearly in the book is Keynes's uncanny foresight. That stemmed in part from his experiences during World War I and in its aftermath. So before Britain started fighting World War II in earnest, Keynes was concerned with how the conflict would be financed. "The purpose of the wartime budget was not to divert resources to the government—that would happen anyway—but to do so with justice and efficiency," writes Skidelsky. Keynes accepted that British households would have to cut back on consumption, but he wanted to keep markets operating without resorting to price controls and rationing.

As a result, he laid out a "middle way" between centralized state planning and completely free markets. "It is for the state to say how much a man is entitled to spend out of his earnings. It is for him to say how he will spend it," argued Keynes. This idea became one intellectual pillar of the Keynesian economies of the postwar era.

Of course, despite what Keynes proposed, Britain did have to implement widespread rationing starting in 1940. But by that time, before victory seemed assured or even likely, Keynes had already begun thinking about what

the postwar global economy would be like. "Keynes used to say, ironically, that he used the calm of war to reflect on the turmoil of the coming peace," notes Skidelsky.

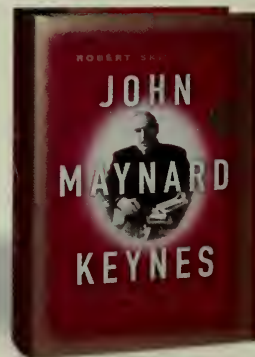
Keynes had both global and personal concerns. As early as August, 1941, he was reflecting on how to set up the world's currency system in a way that could avoid the problems that had led to the Great Depression. At the same time, Skidelsky emphasizes he was worrying about how to keep Britain from going bankrupt as it borrowed from other countries, especially the U.S., to pay for the war. His objective was to help preserve Britain's status as a great power after the war, rather than let it become an economic vassal of the U.S. "America must not be allowed to pick out the eyes of the British Empire," wrote Keynes. Indeed, as Britain's prime economic emissary to the U.S., one of his main responsibilities was negotiating the terms by which America would help fund Britain's war effort.

However, Keynes found that his brilliant mind was no match for America's military and economic might. The 1944 Bretton Woods Agreement, which set up the International Monetary Fund and the World Bank, much more reflected the U.S. vision of the postwar global economy than that of Keynes.

"Keynes gave the Bretton Woods agreement its distinction, not its substance," argues Skidelsky. And all his efforts did not help Britain avoid its economic fate, as the country ended with large external debts after the war and was forced to assume a much smaller global role.

Anyone looking for tales of intellectual triumph would be better off starting with the previous volume of Skidelsky's trilogy. But this book is still worthwhile reading: Skidelsky gives a rare and accurate portrait of a great mind battling with obdurate reality. Keynes operated on a grand scale, and his failures were grand as well.

BY MICHAEL J. MANDIEL
Mandel is BusinessWeek's chief economist.



HE TRIED—AND FAILED—TO SHAPE THE POSTWAR ECONOMY AND PRESERVE BRITAIN'S POWER

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BY STEPHEN H. WILDSTROM

tech&you@businessweek.com

XBOX: IT'S ALL ABOUT THE GAMES



The machine has buzz, but Microsoft and its partners will have to keep the hot titles coming

Microsoft has finally demonstrated that it's not just a one-trick pony. With the release of the Xbox game console, the company has shown that there is life beyond Windows.

Of course, that's not a huge departure. The \$299 Xbox is built around a Pentium III processor and shares the same Intel architecture as every PC that ever ran Windows. And the basic software is a Windows variant.

During the early stages of Xbox development, Microsoft talked about the product as a sort of alternative PC, with networking capabilities and other computerlike functions. What it produced is more limited: a game console aimed at the heart of Sony's PlayStation 2 market, namely teenagers and young men. (The equally new \$199 Nintendo GameCube maintains the company's traditional appeal to a younger audience.)

Xbox's strong suit is graphics. With its 733-MHz processor and fast NVIDIA graphics system, it's capable of producing highly detailed, realistic images even in fast-action sequences. Under the most trying conditions—rapid motion close to walls in a racing game, for example—backgrounds hardly ever break down into blocky pixels. Microsoft says it can generate graphics with twice the detail of PlayStation 2. I can't verify the claim, but the frames look really good on a standard TV and dazzling on a high-definition display.

BORED AND CARSIK. Xbox has several distinctive hardware features. The standard 10-gigabyte hard drive has room for almost unlimited saves of games in progress. The unit comes with an Ethernet connection, but the only thing it can be used for now is linking two Xboxes with a cable. Online gaming through broadband connections isn't due until summer. Dolby Digital audio, when hooked up with appropriate amplifier and speakers, puts out thundering surround sound, although I found game sounds impressive in ordinary stereo. With a \$30 accessory kit, Xbox plays DVDs through your television.

As any gamer will tell you, however, it isn't about the hardware, it's about the games. Since I haven't really mastered a game since Space Invaders, I'm hardly the best person to judge them. I lack the interest or patience to become fluent in the complicated controls games use, and I'm sure aging reflexes have cost me a vir-

tual step or two. However, I put in a fair number of hours sampling some of the more than 10 dozen titles, all of which retail for \$49.99.

Halo, developed by Bungie Software, seems to be the hottest one, and I have to admit that I sucked me in despite my distaste for Quake-type, shoot-everything-in-sight games. It has enough of a story line to keep it interesting, varied assortment of weapons, and some cleverly tricky, vehicles. Once I learned how to move around, and shoot all at the same time, it became addictive.

There is an abundance of car-racing games whose charm eludes me. I tried NASCAR Rivalry (Infogrames) and Project Gotham Racing (Microsoft Games). Both quickly bored me, although Project Gotham generated views realistic enough to cause car sickness. I think I would have liked them better if I had been using a steering-wheel controller, such as the \$60 Mad Catz MC2 Racing Wheel, instead of the standard Xbox controller (Note to Microsoft: The "force feedback" feature produces a gentle vibrating of the controller, a silly sensation when your virtual car just bumps the wall at 150 mph.) I had more fun with



LOSS LEADER? Microsoft is probably losing money on the hardware

Fuzion Frenzy (Blitz Games), a multiple-screen game, and Munch's Oddysee (Oddworld Inhabitants), a sort of psychedelic version of Nintendo's Super Mario.

To turn a critical success into an economic one, Microsoft and its partners will have to sell a ton of games. Analysts who have studied Xbox estimate that despite squeezing every penny of cost out of the design, Microsoft loses \$125 on every unit it sells. The difference has to be made up on royalties and distribution revenues on games.

For a company used to being despised, Microsoft has an odd advantage: It enjoys close relations with developers, who have written games for Windows without paying royalties. This puts Microsoft in the unusual position of being hated less than its competitors, Nintendo and Sony, which have been battling developers over royalties for a long time. If Microsoft keeps the hot games coming, Xbox could be the first big non-Windows winner.

BusinessWeek online

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TECHNOLOGY REPORT

Compaq Helps WorldCom Affiliate Digex Be the Perfect Host

Digex Leverages Compaq ProLiant™ Servers and the Computing on Demand Solution for Delivery of Managed Hosting Services

Compaq has helped Digex, a WorldCom affiliate, rise to become a global leader among managed hosting service providers. Digex delivers best-in-class managed hosting solutions that provide superior application and site performance, reliability, security and scalability. Hundreds of global businesses run their Internet business on infrastructure managed by Digex.

According to Digex, designing and managing complex client Web architectures require components that work well together in a hosted environment. Compaq has delivered process is so effective that it not only forecasts the need for additional capacity but also supports the delivery of Digex's custom ProLiant server builds, and automatically begins ramping them up.



As a managed hosting provider, Digex assumes responsibility for 100% of a client's Internet infrastructure, including the procurement, implementation and management of servers and work and issues early.

solid operating platforms that lend themselves to rapid deployment, with features for automated monitoring that help Digex identify potential

The upside for Digex is ultimate capacity for their hosting customers whenever they need it, a rapid implementation and better cash-flow management. Computing on Demand cuts costs and increases efficiencies by forecasting the future and delivering it.

Compaq began business-critical hosting services with whom they could grow. Digex needed an industry-standard solution to achieve faster global installation, easier deployment and repeatable solutions.

By implementing Compaq's Computing on Demand solution, Digex is able to electronically monitor and fulfill its requirements to provide optimum service levels for customers. The

Through product and program innovation, Compaq has helped Digex become one of the leading companies in the highly complex and competitive field of Managed Service Providers, where you have to prove your capabilities every day.

THE IDEAL BLEND: COMPAQ & STARBUCKS.



Partnership Will Create Breakthrough Wireless Customer Experience

Compaq and Starbucks have announced a five-year strategic relationship in which Compaq was named the Seattle-based coffee company's preferred information technology infrastructure provider for its retail stores and corporate headquarters. Starbucks Coffee Company is the leading retailer, roaster and brand of specialty coffee in the world with more than 4,800 stores worldwide and 50,000 employees. The two companies will work together to blend technology and lifestyle, thereby enhancing the Starbucks Experience and supporting global growth.

Starbucks chose to partner with Compaq to leverage the power of its wireless technology, said Howard Schultz, Starbucks Chairman and CEO. "We want to help create a high-speed connected environment for our customers, as well as the first-time technology experience in America. Compaq has been instrumental in this effort."

IT IS VITAL TO THEIR BUSINESS SO THEY'RE TRUSTING THEIR BUSINESS TO US.



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BY ROBERT KUTTNER

THE LESSON OF ENRON: REGULATION ISN'T A DIRTY WORD



PYRAMID:
Three areas
manipulated
by Enron
need more
government
oversight:
financial
standards,
electric
power, and
pension
regulation

In the wake of the Enron collapse, defenders of deregulation are mounting a heroic effort to insist that the debacle was merely a business model gone bad, not an impeachment of freer markets. But the claim won't wash. In fact, Enron suggests the need for tougher regulation in three distinct areas.

The first is financial standards. Enron could bilk investors because, despite the razzle-dazzle, nobody outside the company could figure out Enron's game. Demands for greater financial transparency were resisted at every turn. The more we rely on markets to achieve efficiencies, the more we need transparent reporting. Otherwise, a deregulated environment becomes too tempting an arena for scams. Only regulators (and their proxies, such as the Financial Accounting Standards Board) can force corporations to disgorge potentially embarrassing information. They didn't with Enron. In this respect, the Enron collapse is reminiscent of Long-Term Capital Management: financial geniuses with a formula that couldn't fail (but did), operating beyond the purview of regulators and taking investors and banks down with them.

It also recalls an earlier sordid chapter in the electric utility industry: the utility holding-company bubble of the 1920s. Those parent companies held controlling interests in local utilities. Like Enron, they operated beyond the reach of effective regulation. They turned out to be nothing but complex variations of old-fashioned pyramid schemes, watering stock and soaking investors. When the pyramids collapsed, helping to trigger the Great Depression, Congress ordered tougher regulation of both securities and utilities.

SHARK CIRCUIT. The second area inviting reregulation is electric power. As California's recent power disaster proved, demand for electricity is relatively inelastic. Spare generating capacity is needed for peak periods. Traditionally, regulated power coexisted with adequate supply and fair prices because the system included both capacity for peak demands and prohibitions on price-manipulation and windfall profits. But deregulation signals entrepreneurs both to shed spare capacity (since nobody wants to pay for it) and to amass the sort of market power that brings price manipulation.

In this climate, it was guaranteed that sharks such as Enron would emerge to cream profits by manipulating supply. And—just as in the 1920s—no regulator could probe what Enron was up to. Ironically, these markets proved too byzantine for the company itself.

Even in a capitalist economy, some major sectors of the economy demand regulation. Clean electricity is one of them. In principle, an efficient regime of electricity regulation could be based on regulated competition that retains traditional markets but tightens the rules and cracks down on abuses. However, the regulatory acumen needed to housebreak future Enrons and keep them honest would require the wisdom and incorruptibility of a philosopher king. The Federal Energy Regulatory Commission, a friend of competition, has lately been issuing price cap orders and exploring the cause and cure of market power, something that competition by definition is supposed to minimize. That's a good start.

But this is a game of catch-up. Better to regulate electric power directly, by regulating production and supply, or generate it publicly. It is hardly accidental that the one oasis of stability immune from the California electric power disaster was the Los Angeles public power district. The power plants were municipally owned, and there were no profit opportunities—hence, no games to be played with supply or price.

RELENTLESS. A final failure of regulation involved the pension system. Enron employees were coerced or compelled to put the bulk of their subsidized retirement savings into—guess what?—Enron stock. When the stock collapsed, so did their retirement dreams. Diversification is the first rule of prudent investment. It is unsound for a corporation to force its employees to put all their retirement eggs in one basket. That, too, should be illegal.

The theorists of deregulation have contended that competition is inherently more efficient because government intervention is corrupted by politics, while markets are cleanly accountable to investors. However, all markets are structured by rules. And the process of setting rules for deregulation, as clearly illustrated by Enron's example, is as politicized as the process of regulation.

Enron was the ultimate politically engaged company. Its chairman, Kenneth L. Lay, was an intimate of the Bush family and was wired to Democrats as well. Enron's operatives relentlessly lobbied state legislatures to provide an climate in which to pursue its market manipulation. The corporation resisted demands for disclosure, and it was not clear who had the power to extract the information. It is emblematic that Marc Racicot, the Republican Party's new national chairman, was, and is, a lobbyist for—well, you know who.

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.

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EDITED BY PETER COY

WHERE WORKERS ARE HIT HARD

The slump is giving tech a pounding

So far this recession has not been as tough on workers as the previous one was. The last recession ran eight months, from July, 1990, to March, 1991, and nonfarm payrolls dropped 1.3%. By contrast, in the eight months from March, 2001, the beginning of the current downturn, to November, employment has declined only 0.9%.

DISAPPEARING TECH JOBS



▲ BEGINNING OF RECESSION=100
*TECH EQUIPMENT MANUFACTURING, COMMUNICATIONS, SOFTWARE AND COMPUTER SERVICES **INCLUDES ESTIMATE FOR NOV. 2001 COMMUNICATIONS EQUIPMENT EMPLOYMENT

Data: Bureau of Labor Statistics

Yet workers in the technology sector have taken a much harder pounding this time. Employment in the key tech industries—software and computer services, communications, and computer, semiconductor, and communications equipment manufacturing—peaked in March and since then has fallen by 3.3% (chart). In contrast, by the time the 1990-91 recession ended, employment in the tech sector had fallen only 1.7% from its 1989 peak.

Within the tech sector, software and computer services, for example, are doing much worse than last time. In the 1990-91 recession, software companies continued to hire new workers almost without interruption, even as the rest of the job market contracted. This time, however, software has stalled with the rest of the tech sector. Indeed, employment at companies providing computer programming services was down in October from the year before, the first such decline since the government started tracking the industry in 1988.

The one tech industry holding up surprisingly well so far is communication services. Despite all the turmoil, the number of communications jobs is up slightly since the recession started,

led by a mild expansion of cable industry employment. This hiring, however, is not enough to offset the declines in the rest of the tech sector.

By Michael J. Mandel

AN ECONOMIC WARMING

How weather muted the downturn

An abnormally mild weather this fall made the U.S. recession milder, according to new calculations by economists at Goldman, Sachs & Co. Warm weather boosted construction spending at a time of year when it normally slows. That factor alone accounts for 0.6 percentage point of Goldman's upward revision in its fourth-quarter forecast for gross domestic product growth, says economist John M. Youngdahl in a Dec. 5 report. Goldman now estimates that the economy will contract at a 1.5% rate in the fourth quarter, vs. its earlier forecast of a 3.5% drop.

Youngdahl points out that every state in the continental U.S. had above-normal temperatures in November, according to the National Oceanic & Atmospheric Administration. States such as Minnesota, Wisconsin, Michigan, and Iowa had markedly warmer weather. "This is precisely the region of the country where cold temperatures can begin to depress unadjusted economic activities around this time of year," Youngdahl says in the report.

Moreover, in a Dec. 7 report, Morgan Stanley Dean Witter & Co. Chief Economist Richard B. Berner says the warm weather lowered heating-oil and natural-gas consumption by as much as 5%. That, plus the 25%-to-30% decline in oil and gas prices since September 11, means Americans will have an additional \$35 billion to spend on things other than energy in the fourth quarter. That's about the size of the tax rebate. "If you combine warm weather with a recession," says Berner, "you've got a recipe for lower energy prices and a real buffer for consumers."

Of course, the news isn't entirely good. Much of the construction spending in the fourth quarter is being moved up from spending that would have occurred next year. There was a similar pattern in 1987, when mild temperatures in the last quarter of that year drove up nonresidential construction spending at a 12% annual rate, only to be followed by a drop at a 6% rate in the following quarter.

By Laura Cohn

NOT SO FIXATED ON BEQUESTS

Why Japanese parents are "selfish"

The Japanese are much bigger savers than Americans and are thought to be much more community-minded. Surprisingly, the Japanese seem to be less evenhanded and altruistic than Americans when it comes to leaving money to their children, according to a study by Charles Yuji Horioka of Osaka University.

His National Bureau of Economic Research paper is called *Are the Japanese Selfish, Altruistic, or Dynastic?* Selfish people, in the language of generational economics, leave money to children in exchange for receiving care in their old age or aim to spend all their money before they die. Altruists leave money to their kids no matter what, with the most altruistic leaving the most to the poorest offspring. Dynastic types make bequests to preserve a family business or name after their deaths, usually leaving all or most to one child.

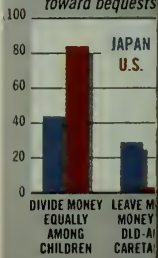
Using data from three surveys conducted throughout the 1990s, Horioka found that "selfishness" is well-trenched in both the U.S. and Japan, but more so in Japan. Depending on the year, 77% to 91% of Japanese respondents said they were unconcerned with amassing wealth for the purpose of passing it on to their children, while 60% of Americans surveyed said the same.

The cultural differences between the two countries were even bigger in a 1990 survey asking how people in each country would split the inheritance they would leave among their children. Twenty-nine percent of Japanese but only 3% of Americans said they would give more to all the child or children who took care of them in old age (chart). That meets Horioka's definition of a "selfish" bequest motive because of the implicit quid pro quo. By contrast, 84% of Americans but only 44% of Japanese said they would divide the inheritance equally among their offspring, showing the difference in cultural norms between the two countries.

By Margaret Popper

WHO GETS THE MONEY?

Surveys of attitudes toward bequests



▲ PERCENT

DBA: Osaka University

JAMES C. COOPER & KATHLEEN MADIGAN

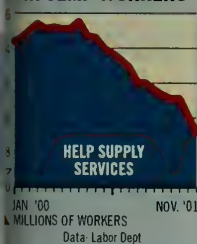
LABOR'S NEW FLEXIBILITY CUTS TWO WAYS

While business benefits, temporary workers are taking the hardest hit

U.S. ECONOMY The 1990s marked a dramatic rise in the flexibility of the U.S. labor markets. In particular, the sharply increased use of contingent workers and variable pay allowed companies to more closely align their labor costs with output. The result: Business was better able to hold down fixed costs even as they coped with soaring demand in the mid-to-late 1990s.

Now, with demand and output falling, the downside of that flexibility is a key factor shaping the outlook for the labor markets, consumers, and the economy. Temporary workers are taking a beating in this recession, accounting for a disproportionately large share of the losses in jobs and incomes (chart). And a greater number of jobseekers can only find part-time employment.

A SHARP CUTBACK IN TEMP WORKERS



As for fewer charges than shedding full-time employees. To be sure, the Labor Dept.'s November job report was grim, which undoubtedly played into the Federal Reserve's Dec. 11 decision to lower interest rates for the 11th time this year. The Fed cut its overnight federal funds rate by a quarter point, to 1.75%, noting "tentative" signs that the weakness in demand was moderating, and that inflation is expected to edge lower next year. Still, it held the door open for another cut next year, citing risks in the outlook that were still tilted toward weakness.

THE JOBS DATA showed that businesses lopped off another 331,000 workers from their payrolls last month, after shedding 468,000 in October. Losses of this size are only seen in recessions. Plus, the unemployment rate continued its upward climb, reaching 7%. That's up more than a full percentage point since July, and the rate is sure to peak at well over 8% next year. Note, however, that hourly earnings increased a sturdy 0.3% from October and 3.9% from the

year before. Pay growth has slowed, but not by much.

The recession's heavy impact on contingent workers is partly responsible for that anomaly, along with its skewed effect on low-skilled and low-paid workers generally. To the extent that those at the lower end of the pay scale are taking the hardest hit, the overall average of earnings is not affected as greatly.

Since March, when payrolls peaked and the recession began, employment at temporary-help agencies has dropped by 375,000. That accounts for 30% of the 1.2 million jobs

WHERE LAYOFFS HIT HARDEST

EDUCATION LEVEL	JOB CHANGE SINCE MARCH (THOUSANDS)	PERCENTAGE OF LABOR FORCE 25 OR OLDER
LESS THAN HIGH SCHOOL DEGREE	-267	9.7%
HIGH SCHOOL GRAD, NO COLLEGE	-956	30.5%
SOME COLLEGE, BUT NO DEGREE	-507	28.0%
COLLEGE GRADUATE	+369	31.8%

Data: Labor Dept., BusinessWeek

lost so far in the recession. The striking point here is that temp agencies account for only 2.2% of total payrolls. Throughout the late 1990s, income brought home by such temp workers typically grew 15% to 20% annually, but pay plunged 9% in the year ended in November.

Temp-agency hires are only a small part of the contingent work force, as defined by Labor in its biennial survey of such workers. Labor also includes some workers elsewhere classified as self-employed or independent contractors. Also, within the temp-agency category, some 21% are employed in manufacturing, which has borne the brunt of this recession. At the time of the last survey in February, there were 5.4 million contingent workers under Labor's broadest definition, comprising 4% of total employment.

THE DEMOGRAPHICS of this group reveal that, to a large extent, the workers who are getting hurt the most in this recession are the ones who were helped by the economy's unsustainable strength in 1999 and early 2000: the least skilled and the least paid, who found work as the jobless rate fell to an equally unsustainable low of 3.9%. Labor says that contingent workers are more than twice as likely as noncontingent workers to be under age 25, that they are slightly more likely to be black or Hispanic, and that those age 25 to 64 are more likely to be high school dropouts and less likely to have graduated from college.

But the trend to lay off the least-skilled extends to full-time workers as well (table). The November job report shows that workers with a high school diploma or less and no college, who make up 40% of all job holders

age 25 or older; have accounted for 90% of the 1.4 million jobs lost in that age group since the recession began. Employment for those with college degrees, about 30% of the group, has actually risen.

In addition to the recession's skewed impact on low-paid workers, other factors will help limit the slowdown in incomes. Clearly, the labor markets will continue to soften in coming months, but employment is declining from an historically high level, and the jobless rate is rising from an exceptionally low level. The result: Labor markets, while loosening, are still relatively tight.

First, note that the percentage of the population who have a job, while down from a record 64.8% in April, 2000, to 63% in November, 2001, has never been this high in a recession. In fact, it is still higher than it was before the 1990-91 recession. In addition, compare today's 5.7% jobless rate with the rate eight months into the 1990-91 recession, which stood at 6.8%, on its way to a peak of 7.8% after the recession ended.

THE GOOD NEWS is that the worst erosion in the labor markets may have already occurred. New weekly claims for jobless benefits are well off their October peak, although they remain somewhat above their pre-September 11 level (chart). Plus, the total volume of claims fell sharply in late November, although that probably overstates the trend of improvement.

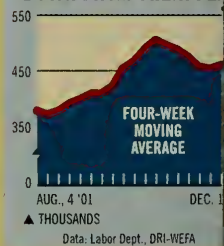
Looking ahead, the higher productivity of the work

force is also a bright spot in the outlook that will bolster both consumer buying power and corporate productivity. Productivity growth, which the Labor Dept. revised downward in the third quarter to 1.5% from an originally reported 2.7%, is still remarkably strong. Moreover, productivity seems likely to rise in the fourth quarter as well. Overall hours worked through November are falling at an annual rate of about 4%. Even if economic output shrinks by 2% this quarter, productivity would still grow on the order of 2%.

Amid such an unusually strong productivity performance in a recession, businesses can offer higher real wages to workers and at the same time keep a lid on their unit labor costs. As a result, consumer buying power can still rise, even as businesses get a head start on shoring up their profit margins.

Flexibility and resilience have been two hallmarks of the labor markets throughout this business cycle. So don't judge the economic health only by the top-line results of the monthly data. This is a fundamentally different economy than it was 10 years ago, and those differences will favorably affect the outlook for the coming months.

JOBLESS CLAIMS ARE DOWN FROM THEIR PEAK



AUSTRALIA

KEEPING A RECESSION AT BAY

While the rest of the world braces for a recessionary 2002, Australian policymakers seem confident that their nation can avoid a downturn next year.

Certainly, Australia remains one of the world's fastest growing economies. In the third quarter, real gross domestic product rose at a 4.4% annual rate. The gain was led by a surge in homebuilding, thanks to low mortgage rates and a large subsidy program for first-time buyers. Consumer spending

also rose, but business investment was flat, and exports—one-fifth of the economy—fell 2.5%. Exports have weakened now that Australia's two major markets, Japan and the U.S., are in recessions.

The fourth-quarter data follow the same mix. Retail sales increased in October, and December consumer confidence was up strongly. But the tourism industry is extremely weak, business loans

are down, and exports were flat in October. The economy may expand by 1% this quarter, which would put real GDP growth for 2001 at about 2.5%.

Capital spending may turn around in 2002, judging by a survey of businesses showing a planned

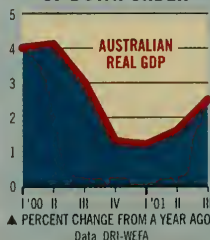
rise in capital budgets. In addition, policymakers are counting on the fiscal and monetary stimulus already in place to bolster growth next year. The Reserve Bank of Australia has cut short-term in-

terest rates six times this year, including a quarter-point cut on Dec. 5. The overnight bank rate now 4.25%, a 28-year low.

On Dec. 6, RBA Governor Ian MacFarlane said that the drags from falling exports and earnings and an inventory adjustment are "not big enough by themselves to cause a recession." He also said that if the global slowdown worsens, the bank "will be prepared to adjust monetary policy accordingly." Australian Treasurer Peter Costello has said that, in addition to the homebuying program, fiscal policy stands ready to help out.

Further policy stimulus will likely be needed. A global recession means Australia can't depend on its important export sector to fuel growth. Instead, rising homegrown demand will be crucial to skirt a recession next year.

GROWTH IS PICKING UP DOWN UNDER





NUMBER OF PEOPLE
ON YOUR NETWORK

NUMBER OF PEOPLE
ON YOUR BACK

RETURN ON COMMUNICATIONS

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ARTHUR ANDERSEN

HOW BAD WILL IT GET?

Enron isn't the first case in which its accounting has been faulted. Now, it may be tougher to win new business

Barely a year ago, Arthur Andersen LLP's new CEO, Joseph F. Berardino, told employees and clients in an inaugural message on the firm's Web site that he was looking forward to "terrific times" and more "robust achievement" at the 88-year-old firm. Today, he is in the biggest fight of his professional life in the wake of the Chapter 11 bankruptcy filing of Andersen's once high-flying audit and consulting client Enron Corp. on Dec. 2. And as the Houston energy company crashes and burns, Berardino may find himself struggling to keep the smallest of accounting's Big Five intact and independent after years of resisting the industry's merger mania.

The biggest corporate collapse in American history has exposed the Chicago-based accounting firm to the possibility of crippling financial damages as well as a severely dented reputation. Enron has left a spectacular trail of nearly \$80 billion in investor losses that have spurred a flurry of announcements of class actions against Andersen. The firm is also facing blistering attacks

from reform-minded members of Congress, such as Michigan's John D. Dingell, ranking Democrat on the House Energy & Commerce Committee, who signaled in a Dec. 5 letter to Securities & Exchange Commission Chairman Harvey L. Pitt that he will haul Andersen over the coals. Dingell suggests that the roughly \$50 million in fees from Enron in 2000—the exact amount is in dispute—may have figured prominently in the firm's auditing considerations. "Could that million dollars a week have played a role in their clouded judgment here?" asks Dingell. Adds R. Ramy Elitzur, an associate professor of accounting at the University of Toronto's Rotman School of Management: "There's no question that it's going to affect their reputation badly."

SPREADING THE BLAME. Berardino knows how high the stakes are. In congressional testimony on Dec. 12, he faulted both his firm and Enron—and the way the accounting profession, Wall Street, and companies police themselves. "Andersen will not hide from its responsibilities," he vowed, admitting that the firm's professional judgment "turned out

to be wrong" in one major Enron auditing decision. But he also cited "possible illegal acts" within Enron, particularly a failure by its execs to share crucial financial data about an important off-balance-sheet deal. Enron denied any wrongdoing. Earlier, in an interview with



"OUR REPUTATION IS ON THE LINE"
Berardino told Congress the firm was "wrong" on one Enron auditing decision

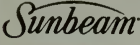
BusinessWeek, Berardino conceded "our reputation is on the line."

Andersen's reputation has taken a hit before. Prior to Berardino's appointment, the firm slogged through a string of high-profile scandals—notably Sunbeam Corp. and Waste Management Inc. In May, Berardino O.K.'d a \$110 million payment to settle Sunbeam shareholder litigation without accepting or denying blame. Several years before, Andersen had signed off on the company's financial statements even after one of its partners uncovered transactions that the SEC

**ENRON
FALLOUT**



An Embarrassing Audit Trail

CLIENT	EVENT	UPSHOT
ENRON 2001 	Enron had to reduce shareholders' equity by \$1.2 billion and consolidate entities that Andersen initially allowed it to account for separately. Reported earnings from 1997 to 2001 were cut by nearly \$600 million.	Enron filed for bankruptcy. Andersen faces shareholder lawsuits and, under subpoena, is cooperating with an SEC investigation.
 SUNBEAM 1997	The SEC alleges that Sunbeam used accounting tricks to create false sales and profits and backdated expenses to inflate results. Andersen signed off on dubious statements even after they were flagged by one of the firm's partners, according to the SEC. Andersen is defending a partner, saying the issue is "differences of professional opinion," not fraud.	Sunbeam went into bankruptcy and is fighting the SEC claim. Andersen paid \$110 million to settle shareholder litigation without admitting or denying blame. The SEC did not accuse Andersen of wrongdoing.
 WASTE MANAGEMENT 1996	Andersen's audit reports were found to be materially false and misleading by the SEC, which ruled that Andersen had engaged in improper professional conduct. The SEC found that Andersen did not criticize company statements that overstated its income by more than \$1 billion from 1992 to 1996. The company was later sold.	Andersen accepted an antifraud injunction and a censure without admitting or denying responsibility and paid a \$7 million civil penalty. It also agreed to pay part of a \$220 million class-action settlement without admitting fault. WM settled with the SEC without admitting liability.

Data: Company reports, court documents, SEC, Andersen.

are fraudulent. In June, Andersen agreed to accept, again without admitting or denying responsibility, an SEC antifraud injunction, along with a censure and a \$7 million fine in the Waste Management case. In late 1998, it agreed to pay part of a \$220 million class action settlement without admitting any fault. The SEC said Andersen hadn't raised objections to company financials that overstated Waste Management's income by more than \$1 billion. "If this were the last big hassle Andersen had with regulators, I think most people would shrug off," says Alan R. Bromberg, professor of corporate and securities law at Southern Methodist University. "But this is the third time, so it'll be hard for people to ignore."

Morale at the firm—battered by the

Enron case and the painful splitting off of Andersen's Accenture Ltd. consulting arm last year after a protracted legal fight—is in the tank, says *Bowman's Accounting Report* editor Arthur W. Bowman. Even Berardino concedes that employees "hate reading the paper every day" and says he's encouraging them to spend time with clients instead. And the air isn't likely to clear anytime soon. For years, regulators, investors, and lawyers will be raking through the wreckage to see what Enron and its auditors should have done. Andersen is putting its Houston office under the microscope by reopening and widening a routine peer review by auditors Deloitte & Touche. Regulators at the SEC and other agencies are scrutinizing Andersen's work as part of a probe of En-

ron. The SEC's Pitt, in an interview with *BusinessWeek* (page 33), promises "a complete and thorough and expeditious investigation."

Berardino, a 51-year-old Andersen lifer, may find the firm's competence in auditing complex financial companies questioned. While Andersen was its auditor, Enron's managers shoveled debt into partnerships with Enron's own executives to get it off the balance sheet—a dubious though legal ploy. In one case, says Berardino, hoarse from defending the firm on Capitol Hill, Andersen's auditors made an "error in judgment" and should have consolidated the partnership in Enron's overall results. Regarding another, larger partnership, he says Enron officials did not tell their auditor about "a separate agreement" they had

with an outside investor, so the auditor mistakenly let Enron keep the partnership's results separate.

Enron says a special board committee is investigating why management and the board did not learn about this arrangement until October. Now that Enron has consolidated such set-ups into its financial statements, it had to restate its financial reports from 1997 onward, cutting earnings by nearly \$600 million. Damningly, the company says more than four years' worth of audits and statements approved by Andersen "should not be relied upon."

The impact on Andersen's business could be severe. Even before the Enron debacle, managers at Wilshire Financial Services Group Inc. in Portland, Ore., owner of the \$800 million First Bank of Beverly Hills, switched to Deloitte &

Touche late last year because they wanted a firm they felt was more adept at accounting for financial institutions. Deloitte "had a competency in our industry that we didn't believe Arthur Andersen delivered," says CFO Bruce A. Weinstein.

The Enron meltdown gives present and prospective clients an excuse to flee. They may want to avoid the heightened attention an Andersen audit might get in shareholder litigation or fear their financial reports could draw more scrutiny from regulators if they're handled by Andersen. "Certainly, it'll be tougher to get new business," says Douglas R. Carmichael, an accounting professor at Baruch College. "I don't think any firm could come away from a disaster of this magnitude unscathed." Berardino says the firm has not lost any clients since Enron came to light.

"We've met adversity before, and every time we've learned from it and gotten stronger and better," he says.

This time, however, Andersen's firm may turn on just how far-reaching the inquiries—and the blame—go. The firm is known for its aggressiveness in winning and keeping business, has largely escaped the consolidations that created other accounting-consulting behemoths. It survived the contentious splitting of most of its consulting operations into Accenture, a move that toppled Andersen from No. 1 in accounting to No. 2. But now, it has become the poster child for accounting blunders—a far cry from "the stand-up firm" that Berardino says Andersen really is.

By Joseph Weber, with Darnell Little in Chicago, and David Henry and Louis Lavelle in New York

COMMENTARY

By Mike McNamee

THE BIG FIVE NEED TO FACTOR IN INVESTORS

When accountants get in trouble these days, the Big Five firms trot out a standard response: The whole system of financial reporting is broken. Whether the issue is auditor independence or Enron Corp.'s nearly \$600 million earnings restatement, the green-eyeshade mandarins point to the chasm between the New Economy and GAAP—generally accepted accounting principles—to explain why accountants can't give investors a clear picture. Securities & Exchange Commission Chairman Harvey L. Pitt is firmly in the New Age camp, so the Big Five get a sympathetic ear.

In Enron's case, these arguments ring hollow. The rules that forced Enron's write-downs have nothing to do with New Economy business models. And if the rules are lax, it's because the Big Five by and large haven't wanted them tightened.

At issue are so-called special-purpose entities, such as the Chewco and JEDI partnerships Enron used to get assets like power plants off its books. Under standard accounting, a company can spin off assets—and the related debts—to an SPE if an

outside investor puts up capital worth at least 3% of the SPE's total value.

Three of Enron's partnerships didn't meet that test—a fact auditors Arthur Andersen LLP missed. On Dec. 12, Andersen CEO Joseph F. Berardino told the House Financial Services Committee his accountants erred in calculating one partnership's value. On others, he says, Enron withheld information from its auditors: The outside investor put up 3%, but Enron cut a side deal to cover half of that with its own cash. Enron denies it withheld any information.

Does that absolve Andersen? Hardly. Auditors are supposed to uncover secret deals, not let them slide. Critics fear the New Economy emphasis means auditors will do even less probing.

The 3% rule for SPEs is also too lax. To Andersen's credit, it has long advocated a

tighter rule. But that would crimp the Big Five's clients—companies and Wall Street. Accountants have helped stall changes.

Enron's collapse may finally break that logjam. Like it or not, the Big Five must accept new

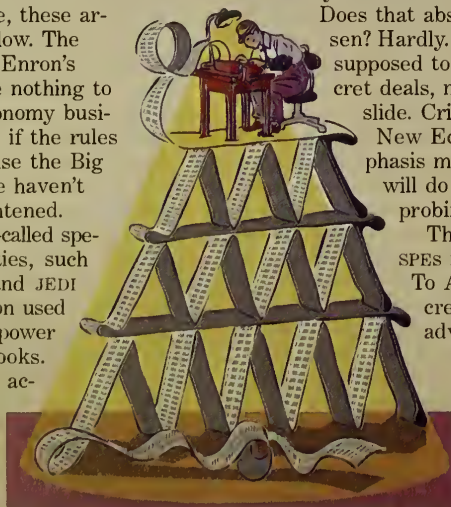
rules that give investors a clearer picture of what risks companies run with SPEs. Audits need an overhaul, too. If auditors are too comfortable with clients to probe for fraud, the SEC should require companies to change auditors every five years.

Outside directors must take a firmer hand, too. On Dec. 12, Pitt issued a reminder that audit committees must examine the accounting for their companies' most sensitive operations. The SEC should go further, requiring audit panels to review all "points of disagreement" where the outside and inside accountants differ.

Old-fashioned GAAP may seem irrelevant in today's fast-paced markets. But as Enron shows, basic bookkeeping still matters. Get the GAAP right first.

McNamee covers the SEC.

**ENRON
FALLOUT**



Auditors are supposed to uncover secret deals—not let them slide

EA

IF YOU VIOLATE THE LAW, YOU WILL PAY FOR IT

Harvey Pitt on how the Enron disaster will affect SEC policy

Securities & Exchange Commission Chairman Harvey L. Pitt has launched a formal investigation into the collapse of Enron Corp., which he calls "a tragedy" for investors. He met in his office on Dec. 10 with Senior Correspondent Mike McNamee to talk about how the Enron debacle affects proposed reforms in accounting and enforcement.

Enron is drawing attention in part because of the company's strong political connections. Are you feeling any heat from the White House or Capitol Hill?

No, I don't think so. The only aspect of Enron we're focused on is what happened to investors and whether the proper compliance with all our securities laws and rules applied. Whoever is or isn't involved with the company is wholly irrelevant to us.

Have Enron's auditors [Arthur Andersen] let us down?

I can't comment on anything specific about who, if anyone, is responsible. We have to focus on assuring people that the problems of Enron will not likely reoccur. First, we want to complement our existing periodic [quarterly and annual] disclosure system with a current disclosure system. Second, we want to ensure the ability of companies to make affirmative disclosures about unquestionably material events. Third, we believe that financial reports need to be put in plain English so that investors can look at a financial statement and tell readily what a company's financial status is.

We are going to take steps to strengthen the role of audit committees [corporate boards]. We believe that it is appropriate for audit committees affirmatively to review with management, and also with outside auditors, the three, four, or five critical accounting principles that have the greatest impact on the company's financial posture. It is not now a duty.



PITT:
"COMMITTED
TO VIGOROUS
ENFORCEMENT"

Last year, your predecessor fought unsuccessfully to separate the Big Five's auditing from consulting, in the name of auditor independence. Enron paid Andersen \$25 million for its audit, but also \$27 million for consulting. Does that raise independence questions?

Independence is very important to the audit function. But the problems that exist are really not a function of independence questions. They go to the integrity and structure of internal control systems and the audit process itself. Is the audit done professionally and competently? To a firm like Arthur Andersen, as significant as the dollars are, they don't make a significant ripple in their overall financial structure—whether it's \$27 million or \$25 million.

Your first speech promised the accountants a friendlier SEC, and you've offered lighter sanctions to companies that cooperate. Do investors have any reason to feel less secure because of the directions you're taking?

If the question is vigorous enforcement in cases of financial fraud, we are at least as committed to vigorous enforcement as has ever been the case. [Enron] is a tragedy. I grieve for the investors who have lost their life savings, for the employees. But Enron occurred in a system in which all of the emphasis was on after-the-fact enforcement.

After-the-fact enforcement is absolutely critical. But it stands to reason that preventing a problem before it arises has to be better for investors than being limited solely to going after the problem after it's arisen. We're not changing after-the-fact enforcement. But what we're trying to do is help companies and auditors get it right up front. My message is: If you violate the law, you will pay for it, and we will be aggressive. But if you are truly concerned about getting it right, we will help you.

The other profession that has not covered itself with glory is Wall Street's analysts.

I think that analysts have to know why

they're recommending a company, and have to understand its true financial position. It's one thing if analysts are deceived by sharp operators. But we cannot have recommendations which are made without an understanding of the company's posture. The public is entitled to know either that there are no conflicts of interest [between an analyst's research and banking roles], or precisely what conflicts there are. I believe that the securities industry will come up with an effective program for dealing with that. If they don't, then we will make sure that investors are protected.

BusinessWeek online

For interviews with Pitt and Andersen CEO Joseph F. Berardino, go to www.businessweek.com.

**ENRON
FALLOUT**

PRIMED FOR FAST-TRACK AND RARING TO GO

If the Senate ratifies the House victory, negotiators will take off



During his two terms, Bill Clinton couldn't persuade Congress to give him fast-track trade authority. But in just his first year, George W. Bush has already confounded skeptics who scoffed at the idea that he would have the muscle to advance his ambitious trade-expansion agenda. On Dec. 6, Bush squeezed out a 215-214 win in the House for a measure that restores the President's ability to negotiate trade pacts without congressional tinkering. As a result, 2002 could mark a string of free-trade dealmaking.

The narrow House victory, expected to be ratified by the Senate, was Bush's third trade policy accomplishment this year. It comes on the heels of a successful November launch of a new round of global trade talks. That coup followed the April decision in Quebec City to revive work on a new hemispheric free-trade zone. And now, armed with the ability to cut deals that Congress can't amend, Bush's trade negotiators will have their hands full. "[This] is going to allow us to really step on the gas in all the trade negotiations," says Franklin J. Vargo, a vice-president at the National Association of Manufacturers. "Up to now, the other countries have just been dabbling at negotiating."

The surprising House victory for fast-track was also a red-letter day for multinationals such as

Boeing Corp. and Caterpillar Inc., which already account for 60% of U.S. exports. The losers: the AFL-CIO, environmentalists, and some consumer groups that had stymied Clinton-era attempts to pass fast-track and kick off new trade negotiations. "This was all about Big Business declaring [its] dominance," says AFL-CIO economist Thea Lee. "It's clear they think they own trade policy now."

So which industries will benefit from the Administration's new powers? First in line will be America's grain farmers, cattle ranchers, and food processors. They're twice as dependent on export

EXPRESS LANE

If President Bush is granted fast-track authority, he could speed up agreements with the following trading partners:

Chile The U.S. is negotiating the elimination of Chile's 11% import tariffs. Set to conclude in January, it could be the first deal reviewed under fast-track.

Singapore The Bush Administration is seeking guarantees against expropriation of investments as well as open access to Singapore's financial services markets.

The Americas The U.S. wants to knit together 34 countries in the Western Hemisphere into the world's largest free-trade zone. A treaty won't be reached until 2005 at the earliest.

sales as the rest of the economy may face far higher trade barriers than other exporters. Next come service industries such as insurance, securities, and construction. Many U.S. services seek 100% ownership of foreign affiliates. Hollywood and Silicon Valley also seek a chance to increase copyright and trademark protections. Manufacturers—especially makers of telecommunications

and computer gear—also stand to gain as barriers to government procurement abroad fall.

Change may come quickly. A free-trade deal with Chile to remove the 11% tariff faced by U.S. exporters may be the first rubber-stamped by Congress under the new fast-track rules. And on May 15, home trading will begin in earnest.

SITTING IN THE CAT SEAT U.S. multinationals stand to boost their export share

for the proposed 34-nation Free Trade Area of the Americas, a zone that would encompass every country in the Western Hemisphere, with

exception of Cuba.

SKEPTICS. To be sure, opponents of Bush trade policies haven't given up. They'll try to derail the fast-track legislation again when the House and Senate sessions are reconciled next year. If the President fails to deliver on several pledges made in the final minute of debate to buy the votes of a handful of House Republicans, they may block. Among the promises: changing U.S. law so that apparel admitted duty-free from Africa and the Caribbean has to be made from cloth first manufactured in the U.S.

There will be political fallout as well. If unemployment continues to climb as most economists expect even during the initial stages of a recovery, Bush will be extolling free trade to an increasingly skeptical public. Undoubtedly, Democrats will lash House Republicans for sending jobs overseas. Among the biggest potential losers: The U.S. textile and apparel industry, which has shed 678,000 jobs since 1994. Also likely to lose as negotiations shift into high gear are industries such as steel that have made ample use of U.S. antidumping protections. The Administration has already put those on the negotiating table.

Still, as the 2002 elections grow nearer, corporate political action committees aren't likely to sit on their wallets when it comes to rewarding their GOP allies. Business will hardly be the only winner if and when fast-track finally arrives.

By Paul Magnusson in Washington

COMMENTARY

By Dan Carney

MICROSOFT COULD STILL LOSE A LOT OF YARDAGE

For a company that's supposedly about to end its four-year legal nightmare, Microsoft Corp. is facing some tough going. Witness the bipartisan barrage of criticism it received in the Senate Judiciary Committee on Dec. 12. Republican Orrin Hatch of Utah said he had "serious questions" about the enforceability of the company's settlement with the Justice Dept. Democrat Herb Kohl of Wisconsin was even more incredulous: "Are we really confident that in five years this settlement will have had an appreciable impact? I'm not."

If nothing else, the hearing proved that Microsoft's enemies have staying power. That became clear when Senator Patrick Leahy (D-Vt.) urged the judge handling the case to "seriously consider" an alternative proposal by nine state attorneys general. The states are pushing a far tougher set of remedies than those agreed to by Justice. The AGs want to force Microsoft to sell a stripped-down version of Windows, include the popular Java programming language in Windows, and make versions of its Office software for additional operating systems.

WISH LIST. On Dec. 12, Microsoft dismissed the states' proposals in a court filing, arguing instead for the Justice Dept. settlement. Small wonder. The states' proposals read like a wish list from the software giant's rivals. If adopted, they would surely hamper Microsoft. Could the remedies stick? Maybe—if the states can win over U.S. District Court Judge Colleen Kollar-Kotelly.

Thanks to California, which has agreed to underwrite most of the cost of litigation, the group has the resources to fight all the way to the Supreme Court. Furthermore, legal

experts agree that the states' proposals are well grounded in anti-trust law. "These proposals are a credible outline of additional penalties that address the findings accepted by the court," says Ernest Gellhorn, a conservative antitrust expert at George Mason University who generally is sympathetic to Microsoft.

Indeed, several of the proposals do a better job of reflecting the June 28 Court of Appeals ruling than does the Justice settlement. Requiring a stripped-down version of Windows, for instance, comes almost directly from the court's finding that Microsoft had unlawfully "commingled" software code from its Internet Explorer browser with Windows to thwart competitors. The government's solution to the problem—merely allowing consumers to delete icons of certain Microsoft programs—was rejected by the court when it turned down Microsoft's petition for a rehearing of part of the case.

Another example is Java. The appellate court slapped Microsoft for illegally quashing the competitive threat posed by Java, which makes it possible for programmers to create applications that can run on any operating system. The Justice settlement doesn't mention Java.

If the state remedies prevail, they could help level the playing field in the tech industry. Creating a stripped-down Windows would make it easier for PC makers to put together an alternative package of software applications from a variety of companies. The remedies addressing Java

and Office aren't likely to cause a major shift in the balance of power, but they could help Java creator Sun Microsystems Inc. and Linux operating-system marketer Red Hat Inc.

The states still face hurdles. For one, they may never get their day in court. Before Judge Kollar-Kotelly begins hearings on their proposals next March, she must evaluate Justice's settlement. She could simply accept the Bush Administration handiwork, making it hard for the states to press their case. For that reason, says Iowa Attorney General Tom Miller, "we hope she doesn't rule on the [Justice settlement] until she has heard from us." The betting is that Miller will get his wish, but it's no sure thing.

If the AGs do get a chance to make their case, the hearings could get ugly. Microsoft will fight them tooth and nail. Indeed, Microsoft lawyer Charles "Rick" Rule told the Judiciary Committee that his client already had given up more than it wanted in the deal with Justice. "Quite frankly," he said, "[this] is the strongest, most regulatory conduct decree ever." But the AGs are not about to give up. They have already come further than many expected. And it now looks like Microsoft may face more opponents than it bargained for.

With Jay Greene in Seattle



BLOCKING GATES

Dissatisfied with the Justice Dept.'s Microsoft settlement, nine states are pushing for tougher remedies

PROPOSAL: Microsoft would have to offer a version of Windows stripped of extras such as Internet Explorer.

PROSPECT: FAIR "Unbundling" is the biggest omission from the Justice settlement.

PROPOSAL: Windows would include Java. Without that software, users can't see parts of some Web pages.

PROSPECT: FAIR The Court of Appeals repeatedly criticized Microsoft for snubbing Java.

PROPOSAL: Microsoft would continue making Office for Apple and add other non-Microsoft operating systems.

PROSPECT: POOR Office has never been found to be an unlawful monopoly.

EDUCATION

A BOLD NEW LESSON PLAN FOR U.S. SCHOOLS

Bush wins a stronger federal role, but the states are wary

In the end, President Bush didn't get everything he wanted on Dec. 11, when the House and Senate ended more than six months of partisan wrangling over school reform. But he won enough to be able still to call himself the Education President.

Indeed, the compromise legislation that emerged sets a new direction for

are there," says Krista Kafer, an education policy analyst at the conservative Heritage Foundation.

Still, it's not clear just how effective the aggressive new federal role will be. Washington provides just 7¢ of every dollar spent on education. The new bill, which the President is expected to sign by Christmas, offers \$26 billion, not

ment is the testing provision—Bush's greatest victory. State-devised tests will be used to measure a school's performance. The challenge will be for states to come up with exams that measure what's taught by their particular curricula, which differs from state to state. **NO VOUCHERS.** Bush gave ground on how to use tests to hold schools accountable. Originally, he wanted vouchers that would let students at failing schools use their public dollars at other public or private school. That didn't get past Senator Edward Kennedy (D-Mass.). Instead, parents will be able to transfer kids from a failing institution to another public school in the same district. They also can tap up to \$1,000 in federal funds for tutoring and other programs.

This middle position may reassure educators that laggard schools will be prodded without undermining public education. "Allowing parents to transfer to public schools is no problem [all] schools get the support they need, there's a lot in this to do that," says American Federation of Teachers President Sandra Feldman. The bill also boosts Title I money, which goes mostly to poor children, by about 20%, to more than \$10 billion.

The Bush Administration also split differently with Democrats on flexibility. The White House didn't win the right for states to decide how to spend federal dollars. In fact, it gave up on a pilot program the Democrats had agreed to last spring

that would have given such freedom to 15 states. Still, school districts now have more latitude to spend federal money on, say, reducing class size.

All the give-and-take has left a lot of the major players in Washington dissatisfied. Even Bush's setback on spending—Democrats boosted outlays by \$1 billion—will advance his education goals. One disgruntled group: state lawmakers, who fear that testing will be an unfunded mandate. After all, they're the ones, along with local school districts, who can make or break reform.

By Aaron Bernstein and Lori Woollert in Washington



ALL EARS: U.S. schools. For the first time, every American child will be tested in reading and math every year between grades 3 and 8. While annual testing remains a controversial idea, the goal is to create a yardstick by which to measure the progress—or failure—of individual schools. The bill also gives school districts more flexibility to spend federal education dollars. And it introduces more accountability, giving parents more options at chronically failing schools. "Bush won at least something in every area, so the basic themes of his plan

nearly enough money to address such problems as the glaring inequities between affluent and poor schools, says John F. Jennings, head of the Center on Education Policy, a nonprofit group in Washington. It won't even cover the costs for each state to develop its own tests. In fact, the Administration has promised to waive the bill's timetable for several states that fear they can't meet it because of shrinking coffers, education lobbyists say. "The bill is a major achievement, but the problems with education are a lot bigger than what it will pay for," says Jennings.

At the center of the Dec. 11 agree-

THE COMPROMISE

The new education bill Congress has agreed on gives President Bush much, but not all, of what he wanted:

✓ ACCOUNTABILITY Parents can transfer children in failing schools to other public schools, but Bush lost out on vouchers for private institutions.

✓ FLEXIBILITY Local school districts will be able to decide how to use up to 50% of federal funds. But the President failed to get a similar right for states.

✓ FUNDING The bill provides \$26 billion for education, up from the \$19 billion Bush proposed.

✓ TESTING A key Bush proposal, in which schools will test every student in grades 3 to 8 every year in reading and math also passed. In addition, a sample of pupils from each state will be required to take a national test to measure progress.

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LITIGATION

THE ASBESTOS MONSTER: HOW SCARY FOR HALLIBURTON?

Damages may be a greater threat than the company realizes

Back in 1998, when he was CEO of oil-services giant Halliburton Co., Vice-President Dick Cheney bought smaller rival Dresser Industries Inc. On Dec. 7, the deal exploded on his former company. When a little-known former Dresser subsidiary suffered defeat in a key asbestos litigation case, worried investors sent shares plunging 42%, to \$12.

Halliburton was already well off its 52-week high of \$45 because of falling energy prices. Now investors are scared the company is about to get eaten by the asbestos monster—the same one that bankrupted Johns Manville and Owens Corning. With their coffers empty, asbestos lawyers are now going after other companies such as Halliburton, Viacom, and Pfizer. Although none of them produced the flame retardant, all sold products containing it or bought companies with asbestos exposure.

Current CEO David J. Lesar allayed fears somewhat. He vowed to appeal the rulings, announced that Halliburton has more than \$2 billion in liability insurance, and laid out his litigation strategy for analysts. But his chances of reducing the awards may be tougher than investors realize.

Halliburton is laying the blame for its woes on a predictable target: the runaway jury. The company says that from 1976 until this year, it settled 194,000 claims for an average of about \$200 apiece after insurers chipped in their share. Then, this fall for-



CEO LESAR: *Trying to calm his shareholders*

mer Dresser unit Harbison-Walker, which marketed a variety of products containing asbestos, suffered four big losses in a row whose awards totalled \$152 million.

FEWER DEFENDANTS. These cases, for complex reasons, were not originally handled by Halliburton's litigation team. As a result, Lesar argues, they're anomalies. Over the long run, he says, the cost of the company's lawsuits will return to its long-term average. "There



CLEANUP: *By now, plaintiff lawyers have a good idea of how to sway juries*

DANGER!

Shares of many U.S. companies have been hit by growing fears of asbestos liability exposure. Among them:

VIACOM

The media giant faces liabilities from discontinued manufacturing operations at Westinghouse Electric, which merged with CBS in 1995. As of Sept. 30, Viacom had about 129,910 asbestos cases pending.

GEORGIA-PACIFIC

Its 1965 acquisition of Bestwall Gypsum has resulted in some 290,000 asbestos-related claims since the 1980s. Although most have been settled or dismissed, thousands are pending.

PFIZER

The No. 1 drugmaker's 1968 purchase of Quigley and its deal last year for Warner-Lambert, whose subsidiary sold clothing that failed to protect workers, have brought 59,000 ongoing personal injury claims.

has been a huge overreaction to the events," explains the embattled chief.

Problem is, that's not the way asbestos litigation works. Pointing to earlier damage awards is all but useless because the liability keeps expanding. As more companies go bankrupt, the number of defendants left to make payments decreases. And under legal rules that are more concerned with compensating victims than protecting shareholders, a company with partial responsibility for a person's injuries can be held responsible for all of the damages. "Halliburton has been able to stay under the radar without making big payments because we've focused on the other defendants," says Karl E. Novak, an attorney in Mount Pleasant, S.C., who brought one of the Texas cases. "Now that some of those other companies are bankrupt, people are starting to look more closely at Halliburton."

ACE CARD? That's not the only reason attorneys will be looking at Halliburton in a different light. Trials are like focus groups: Opposing lawyers get to tell their stories and see which one juries like better. Now that plaintiff attorneys have been successful in trial, others bringing suit will accept cheap settlements.

Halliburton does have a potential escape hatch. The idea of limiting asbestos liability has been kicking around in Congress for years. And the company has contributed more than \$100,000 to legislators who supported the notion. Cheney even kicked in \$13,000 when he was a corporate officer. Now that he is in power, many analysts hope the company will benefit from favorable legislation.

But for now, congressional relief seems distant. Lawmakers have higher priorities next year. And of course, if Cheney were to participate, it could prove to be a huge public relations obstacle.

Does this mean Halliburton will be driven into bankruptcy? Not at all. Plenty of companies have been managing big asbestos dockets for years. But if history is any guide, the company has a rough—and costly—road ahead.

By Michael France in New York and Stephanie Andersen Forest in Dallas, with Laura Cohn in Washington and Michael Arndt in Chicago

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BIOTECHNOLOGY

DEAL-HUNGRY, JUST LIKE BIG PHARMA

Now biotech is out to expand product lines and sales reach

In the wave of big biotech acquisitions in the last few weeks, some trademarks of past deals are conspicuously absent. Gone are speeches about revolutionary science and promises of lush medical rewards on the distant horizon. The highlights now are purely practical: Millennium Pharmaceuticals Inc. is buying COR Therapeutics Inc. to get a sales force and an established anti-clotting drug. MedImmune Inc. is swallowing Aviron to get hold of a nasal spray flu vaccine. Cephalon Inc. is buying its French partner, Group Lafon, partly to acquire a European sales staff.

These biotechs are acting like deal-hungry pharmaceutical companies, and that shouldn't be any surprise. For years, they've wowed investors with stories that were more about impressive laboratory developments than predictable earnings. But with Wall Street now looking for concrete evidence of growth, the biotechs are racing to expand product portfolios beyond one or two hits and build out infrastructure to manage everything from drug discovery to sales forces that can compete with the likes of Pfizer Inc. Given those objectives, the recent flurry of deal-

making is probably just the beginning. In short, says Dr. Stanley T. Crooke, chairman and CEO of Isis Pharmaceuticals: "Biotech is growing up."

There's no shortage of potential targets for future deals. Analysts are watching Palo Alto (Calif.)-based CV Therapeutics Inc., which is developing a promising drug to treat angina that could hit the market as early as 2003. Another biotech, Transkaryotic Therapies in Cambridge, Mass., is awaiting approval of a drug called Replagal aimed at a rare metabolic disorder called Fabry disease. And two closely watched biotech players, Foster City (Calif.)-based Gilead Sciences Inc. and Trimeris Inc. out of Durham, N.C., have breakthrough HIV drugs just hitting the market or in late-stage development. The Trimeris compound, under co-development with Hoffmann-La

ATTRACTIVE TARGETS

Product pipelines at these companies could attract suitors or partners:

CV THERAPEUTICS Has promising drugs in development, including ranolazine, for angina, which could launch in 2003 and top \$500 million in sales.

GILEAD SCIENCES Its HIV drug was just approved, and a Hepatitis B treatment is in development. Combined sales of the two could top \$1 billion.

TRANSKARYOTIC THERAPIES Awaiting Food & Drug Administration approval for Replagal, a treatment for a rare metabolic disease. This could blossom into a \$300 million drug.

TRIMERIS Its 50-50 partnership with Hoffmann-La Roche is developing "fusion inhibitor" drugs for HIV. The first could exceed \$400 million in revenues.

Data: Mohr Partners, Lehman Brothers & SG Cowen

Roche, could top \$400 million in annual revenues, says Lehman Brothers Inc.

Any of these companies could make attractive partners—or tasty prey. And biotechs aren't the only ones on the prowl. Big Pharma also is looking for new products, which is why Bristol-Myers Squibb Co. struck a \$1 billion

MILLENNIUM: A deal this year to co-develop ImClone Systems Inc.'s cancer therapy. But right now, biotechs

seem even more eager for deals. Without them, says J. William Tanner, an analyst at SG Cowen Securities Co., companies such as Amgen, Biogen, and Genentech may be hard-pressed to put the high growth rates investors expect—especially as they must generate that growth off a much larger revenue base than in their early years.

SWEETER OFFERS. If the biotechs are looking to buy or license potential blockbuster, though, the deals won't be cheap. This sector raised a record-breaking \$31 billion in capital in 2000 and another \$9.4 billion in the first three quarters of 2001. That means even small companies can hold out for sweeter offers. As a seller now, "you can craft deals that are much more favorable," says Dr. Louis G. Lange, chairman and CEO of CV Therapeutics.

Millennium, of Cambridge, Mass., illustrates the dynamics at work. Initially a provider of genomics technology and data to big drug companies, it has become a drug-discovery and development operation. The COR deal brings Millennium a share of the \$230 million in annual sales of Integrilin, an anti-clotting therapy that's co-marketed with Schering-Plough Corp. Joseph P. Dougherty, senior

biotech analyst at Lehman, says cash flow from Integrilin will help Millennium fund development of its own drug candidates—a hedge if raising money on the capital markets becomes difficult.

Moreover, COR brings a sales force with experience in cardiovascular drugs. "We were missing scale and commercial capabilities...to handle what's coming out of [the company's labs]," says Kevin P. Starr, Millennium's chief operating officer. That's a common plight for many biotechs—and a reason deal-making will only intensify.

By Amy Barrett in Philadelphia, with Catherine Arust in New York and John Carey in Washington

SHOPPERS ARE BEATING A PATH TO THE WEB

Online Christmas sales are surprising even the dot-coms



Durt Allen was pleasantly surprised when he visited RitzCamera.com earlier this month to check out a sh attachment he's hoping to buy. Moments after he typed in an e-mail question to customer service, a live representative responded. Getting such personal service impressed him. Now, Allen plans to do much of his Christmas shopping on the Internet. "You don't pay tax, and you don't have to drag yourself to the mall," he says. "You're really making out like a bandit."

Allen has plenty of company this year. In contrast to sluggish, single-digit sales growth at many traditional retailers, online sales hit a record \$1.5 billion for the week ending Dec. 2, putting fourth-quarter online sales on track to \$10 billion, 12% above last year's to according to market researcher comScore Networks Inc.

Indeed, it's shaping up to be a pretty good year online. Market researcher eRate, which tracks 2,000 e-commerce sites, forecasts a 31% increase in online sales this year—for a total of \$33.3 billion. Says AOL Time Warner Co-Chief Operating Officer Robert W. Pittman: "The economy is bad, but when you look at the statistics for people shopping online this year, Internet retailing is not slowed down at all."

Of course, e-tailing remains a tiny fraction of overall retail sales: just 2% this year. And sales growth has slowed in previous years. Still, the trend does well. Why? Analysts say Web shopping is becoming more mainstream. Nearly one-third of U.S. adults shop online, according to market researcher

Nielsen//NetRatings. Although the demographics are still skewed toward high-income and high-education brackets, 60% of this year's online shoppers are women, up from 39% two years ago.

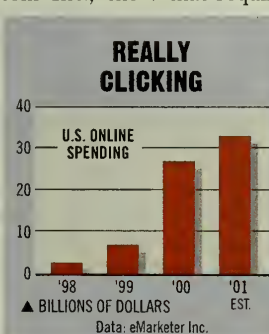
That's cause for a huge sigh of relief, if not outright celebration, among big-name e-tailers. Amazon.com Inc., the

leading online store, said that in the three days after Thanksgiving it sold 700,000 items more than it did during the same period last year. Toys 'R' Us, too, got a boost from its prominent placement on Amazon.com's Web site. Toysrus.com reported in November a 70% increase over last year's fiscal third-quarter sales,

to \$39 million. EBay Inc., the auction site, may do best of all during the holidays. On Dec. 11, W.R. Hambrecht reported that eBay was on track to beat fourth-quarter estimates for revenue of \$209.1 million—a 55% increase over last year. EBay stock is trading at about \$70 a share, up from a low of \$26 last January.

USER-FRIENDLY. It helps that many e-tailers are making the shopping experience more friendly. According to a November survey by Goldman Sachs, Harris Interactive, and Nielsen//NetRatings, customer satisfaction with online shopping increased 17% in the past year. Most sites are now doing a much better job at the really basic stuff: Toys 'R' Us Inc., for example, has improved the

search process. The company used to offer categories of toys for children age 2 to 4. Now, it breaks them out year by year to narrow down the selection and speed up the search. Walmart.com has also made its site easier to shop, with a better search function and a checkout that requires fewer clicks.



With customers happier, e-tailers have, in many cases, been able to dispense with their usual sales promotions. BlueLight.com, the online outlet for Kmart Corp., offers free shipping on only a handful of items. Says CEO Richard Blunck: "I am more than happy to let the guy who's hell bent on getting free shipping go to

another site." Even with fewer incentives, BlueLight.com has enjoyed a 45% jump in sales this holiday season.

Will a healthier business climate spruce up the earnings of the long-maligned e-tailing sector? Analysts point out that companies such as Amazon are having some success getting their costs in line, thanks to the cutbacks on free shipping and other freebies from the go-go years. Few, however, are yet ready to predict when these e-tailers will make a profit. Still, if online shoppers keep clicking that "buy" button, e-tailers will have not only a merry Christmas but a better New Year.

By Jeanette Brown, with Heather Green, in New York, and with Wendy Zellner in Dallas

EDITED BY MONICA ROMAN

FOR SALE: USED XEROX IDEA MACHINE

CASH-STRAPPED XEROX IS spinning off its famous Palo Alto Research Center on Jan. 1 and looking for equity partners to increase its research might. Xerox spokesman Bill McKee says the move is "another step in returning this company to profitability." While it is not the largest Xerox research center, PARC is certainly the best-known, with inventions ranging from the laser printer to the graphic user interface adopted by Apple Computer. But the center is renowned equally for developing many technologies on which Xerox failed to capitalize.

While some analysts question the appeal of investing in the 270-person PARC, McKee says that Xerox has spoken with more than 40 "seriously interested" partners and plans to retain a significant stake in the venture itself. The company's six other

research centers will remain in-house.

NO RELIEF FOR BRISTOL-MYERS

BRISTOL-MYERS SQUIBB FACES headaches on several fronts. On Dec. 12, a group of 29 states and Puerto Rico filed a lawsuit in the Southern District of New York alleging that the drugmaker improperly blocked generic competition to its anti-anxiety drug BuSpar. The suit contends Bristol made false statements to the Food & Drug Administration concerning a patent, a move the states say kept generics off the market for nearly four months. The suit comes as Wall Street is growing nervous that Bristol will have weaker-than-expected results next year, when a generic version of its blockbuster diabetes drug Glucophage is likely to hit the market.

THE PRITZKERS: SQUARING ACCOUNTS

HOPING TO SPRUCE UP ITS public image, the multibillionaire Pritzker family agreed to pay \$460 million to federal regulators to resolve claims in the collapse of the Superior Bank, a defunct subprime lender it half-owned. The family, operators of the Hyatt chain, admitting no fault in the thrift's fall, put down an initial \$100 million on Dec. 10. The rest is to be paid over 15 years at no interest. But the settlement doesn't end the fracas. The Pritzkers may pursue claims for damages against former partner Alvin Dworman, a New York developer they blame for the thrift's demise. And regulators may pursue auditor Ernst & Young, as long as the Pritzkers receive 25% of any resolution amount, under a deal the family made with the feds.

HEADLINER: CHARLIE ERGEN

HELL ON THE HILL

CHARLIE ERGEN, THE POKER player turned satellite-TV mogul, may have to up the ante in Washington to get federal approval for the planned \$25.8 billion merger of his EchoStar Communications with DirecTV. The merger has so far gotten a lukewarm reception from a pair of House committees, which worry that consumers in rural areas without cable TV would be forced to pay higher prices if the two largest satellite-TV companies merged. Ergen, whose proposal is opposed by the National Association of Broadcasters, will likely be forced to seek a deal with



regulators to protect rural consumers from huge rate hikes. In a tight battle with cable operators to lure customers, Ergen saw his cost structure take another blow when an appeals court ruled that satellite companies must adhere to the same federal "must carry" rules as cable operators and provide viewers with most of the TV channels in their areas. Waiting in the wings as Ergen struggles in Washington: failed bidder Rupert Murdoch. His News Corp. would likely make another bid if EchoStar is blocked.

Ronald Groves

NASTY SIDE EFFECTS FOR MERCK

MERCK IS AILING. ON DEC. 11, the drugmaker dropped a bombshell when it said that its 2002 earnings would be flat instead of the 8% gain Wall Street was expecting (BW—Dec. 17). The news sent Merck stock down 9.4%, to \$60.70. The disappointment stems from looming generic competition to key drugs and weaker-than-expected sales for Vioxx, its arthritis drug. Vioxx growth has stalled in the wake of concerns about cardiovascular side effects.

AMEX IS STILL TRAVEL-SICK

AMERICAN EXPRESS SAID ON Dec. 12 it would slash up to 6,500 more jobs and take a \$240 million to \$280 million charge in the fourth quarter to cover the cost of consolidating and severance. The

latest layoffs are in addition to 7,700 earlier job cuts. It brings the company's total job cuts this year to 15% of its workforce. American Express has been hard-hit by the decline in travel since September 11, and the stock closed Dec. 12 at \$33.42, off 2.4%. Analysts say that the company's woes aren't over and that it may have to take more charges in 2002. The latest restructuring steps are expected to save American Express about \$230 million to \$250 million next year.

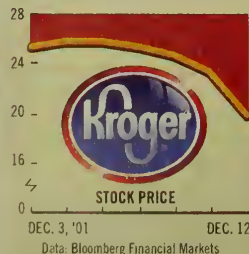
ET CETERA...

- A federal judge has dismissed lawsuits alleging that Enron misled investors about the safety of the Explorer stock.
- Nestlé acquired Ralston Purina in a \$10.3 billion deal.
- Sotheby's may be put up for sale following the pre-filing conviction of Chairman A. Alfred Taubman.

CLOSING BELL

CUT TO THE BONE

Kroger's Dec. 11 announcement that it would lay off 1,500 employees and cut \$500 million in costs sent the stock of one of the nation's largest grocers down 14.5%, to \$19.92. Kroger also said that its strategy to offer consumers lower prices will reduce its earnings over the next two years.



EDITED BY RICHARD S. DUNHAM

THE RELIGIOUS RIGHT ISN'T WEAKER—IT'S JUST DIFFERENT

Recent history has been hard on the Religious Right. Two Christian conservatives failed miserably in their 2000 Presidential bids. The Reverend James Dobson, influential leader of Focus on the Family, has renounced Washington to tend to his flock in Colorado Springs. The Christian Coalition, hemorrhaging money and members, is poised to join the Moral Majority on the political scrap heap. And on Dec. 5, Pat Robertson, the crusade's most visible champion, resigned as the coalition's president.

So it's understandable why some pundits are declaring the once-mighty movement dead. That's premature. It's the end of an era—not of the Religious Right. The reason: The official conservative campaign that TV evangelists like Robertson and Jerry Falwell helped launch 25 years ago is being transformed from top-down movement led by controversial religious leaders into a mainstream political force with a grassroots focus. It is insinuating allies into institutions of power—from government to industry to college campuses—and has become a crucial component of the GOP's base. Rather than ministers-turned-politicians, the new face of the Religious Right is small-businesspeople and PTA officials who lobby at the local and federal level for education reform and tax cuts for families.

In many ways, the most prominent spokesman for Christian conservative causes these days is President Bush. He has shut off federal funds for groups that support abortions overseas and often speaks of the importance of spirituality in his life. He has given social conservatives a seat at the policy table through regular briefings with Bush political guru Karl Rove. And he has named a number of Religious Right allies to key positions within the Administration. Among them: Attorney General John Ashcroft, a born-again Christian and lay minister; Kay Cole

James, former dean of Christian Regent University and now director of the Office of Personnel Management; and University of Chicago bioethicist Leon Kass, a cloning foe who heads a White House council on bioethics.

"EMBARRASSMENTS." Many conservatives are pleased by the departure of Robertson, 71, and marginalization of Falwell, 68, who blamed the September 11 attacks on gays, pagans, and the American Civil Liberties Union, among others. "Robertson and Falwell became embarrassments to the movement," says former Christian Coalition lobbyist Marshall Wittmann.



ROBERTSON: Stepping down

Filling the vacuum will be people like Ken Connor, 54, president of the Family Research Council, a think tank and lobbying group with a \$10 million budget; Beverly LaHaye, founder of Concerned Women for America, an advocacy group that claims 500,000 members; and Rick Scarborough, founder and president of Houston-based think tank Vision America. "We're not going to be led by giants any longer," says Michael P. Farris of the Home School Legal Defense Assn. "Instead, you will see a coalition. It's harder for the Left to attack you when there's a variety of leaders." Still, adds conservative mainstay Paul Weyrich of the Free Congress Foundation, "leadership problems will take care of themselves if you have troops."

Besides trying to restrict stem-cell research, forbid partial-birth abortion, and push for more tax cuts, the new breed must reverse the decline in voter turnout. While 15 million fundamentalists voted in 2000, the GOP had expected 4 million more. Says Rove: "We may be seeing...some return to the sidelines of previously involved religious conservatives."

Will the new leaders be able to rally the faithful? It won't take long to find out. Republicans are counting on them to deliver the votes needed to keep control of the House in 2002.

By Lorraine Woellert

CAPITAL WRAPUP

THE HOUSE AFTER ARMEY

House Majority Leader Dick Armey's surprising Dec. 12 retirement announcement will consolidate conservative dominance of the House Republican caucus, but it also is likely to elevate a key ally of President Bush. Squeezed out once again are GOP moderates, who hold no top leadership roles. Even before



Armey officially announced his departure, the No. 3 GOP leader, Majority Whip and fellow Texan Tom DeLay, had scared off all serious rivals for the No. 2 job. Dems are gleeful that such a hard-liner will be the top House Republican spokesman and strategist. With the House already beset by partisan squabbling, DeLay's promotion could make the poisonous atmosphere positively lethal—and give Dems more ammo for the 2002 campaign.

The early favorite to replace DeLay as chief GOP vote-counter and arm-twister: staunch conservative Repre-

sentative Roy Blunt (Mo.), an early and ardent supporter of Bush. During the 2000 campaign, the low-key Blunt served as Bush's liaison to House Republicans. His ascension would give the Prez a stronger voice on the Hill.

Family considerations may have played a role in Armey's retirement. His son, Denton County Judge Scott Armey, is a possible candidate in his father's newly redrawn, heavily GOP district. With a filing deadline early in 2002, Dick Armey's exit could give Scott an edge over other contenders.

By Richard S. Dunham

FRANCE

ALL VIVENDI WANTS FOR CHRISTMAS...

Can the debt-heavy media giant land USA Networks?

Vivendi Universal chief Jean-Marie Messier is on the prowl again. On Dec. 11, the boss of the French media conglomerate confirmed he was in talks with Barry Diller to buy the entertainment holdings of Diller's USA Networks. The deal could be worth \$10 billion or more and would give Vivendi access to more than 84 million U.S. television viewers. Messier says he also wants to forge an alliance in Europe with U.S. cable-TV magnate John C. Malone, whose Liberty Media also owns 21% of USA Networks.

Messier is clearly enjoying his new role as a media mogul. Over the past few months he has shed more than 30 pounds and moved his family into a Park Avenue duplex, jetting back regularly to Vivendi's Paris headquarters on the company plane. The 45-year-old Frenchman has the stage to himself now: On Dec. 6, exactly a year after Messier sealed the acquisition of Seagram Co. and its Universal media properties, Seagram heir Edgar Bronfman Jr. stepped aside as Vivendi's executive vice-chairman.

But Messier's latest round of wheeling and dealing is making some people nervous. Vivendi shares sank 5% after word of the Diller talks got out. One worry is Messier's tendency to blab about deals, even when he's nowhere near closing them. Sources close to Diller and Malone say that while both have talked some with Vivendi in the past year, no announcement is imminent. A source close to Messier confirms this and speculates that Messier may be trying

to "prod things along" by going public.

Debt is another concern. Messier has already promised investors Vivendi wouldn't issue shares to finance a USA Networks acquisition, and that any such deal would involve putting up only a small amount of cash. Investors hope he keeps his word. Over the past year or so, Messier has run up nearly \$18 billion in debt, giving Vivendi a 50% debt-to-equity ratio that's considerably above those of media companies such as AOL Time Warner, News Corp., and Viacom.

Messier's best bet would be an asset

Longtime Hollywood player Diller is in no rush to make a deal

USA PRODUCES SHOWS LIKE LAW AND ORDER SVU



shuffle. Here's how it could work: Vivendi would give Diller the 43% of USA Networks that Vivendi now owns. Diller would walk away with full control of USA Networks' nonentertainment holdings such as Ticketmaster and Home Shopping Network—plus, probably, a substantial cash bonus. In return, Vivendi would get full control of the USA Networks and Sci-Fi cable channels, as well as Studios USA TV, which produces such shows as *Law & Order SVU* and *Maury*.

Messier would also love to sell Vivendi's 22% stake in British pay-TV operator BSkyB to Malone's Liberty Media. British regulators could block such a sale because Liberty already owns 25% of British cable operator Telewest Communications PLC, a BSkyB competitor.

NEW AUDIENCES. It's a tangled tale, but there's strategic logic at work here. Taking control of USA Networks would give Messier new audiences for Universal films, while developing new TV programming based on Universal's film library. Besides, despite Vivendi's stake in USA Networks, Messier has been unable to influence programming there: Diller has the voting rights to Vivendi's

shares. Diller's control has frustrated Messier, who said recently: "I want to make sure we don't leave money on the table" by neglecting synergies between USA Networks and Vivendi.

Cozying up to Malone would have benefits for Malone's Liberty Media Corp. recently acquired a majority stake in the parent company of Europe's biggest cable-TV operator, United Pan-European Communications. Liberty is awaiting



MESSIER

Bonanzas from the Net are proving hard to come by

as Limp Bizkit or Ja Rule on their handsets. In fact, even though Cegetel is one of his biggest moneymakers, Messier is expected to sell it because it's not hefty enough to compete with Europe's bigger operators.

LEFTOVER DRINKS. Meanwhile, regulatory delays and market weakness have delayed Vivendi's planned disposal of the former Seagram drinks business, as well as a professional publishing unit and its stake in BSKyB.

The failure to close these sales has kept the debt levels surprisingly high at Vivendi, which makes investors jittery. Analysts in France were startled in early December when Vivendi sold a 9.3% stake in its separately traded utilities unit, Vivendi Environment, to raise \$1 billion. Only a few days before the sale, Vivendi Environment had issued a profit warning that pushed its share price down to its lowest level in 15

regulatory approval for Malone's bid to buy six regional cable-TV networks in Germany from Deutsche Telekom. Messier would like to get Vivendi programming, such as its nineteenth Street premium channel, onto Malone-controlled cable properties in Germany and Britain.

These are conventional distribution deals, but at least just what Messier needs. True, Vivendi is on track to post a healthy 10% increase in operating earnings this year, on sales of \$10 billion, with strong showings from its Universal Studios and telecommunications holdings. Messier has wisely edged its bets on the Internet, with first-half losses on its Web investments totaling only \$90 million. Compare that with media rival Bertelsmann, which lost \$790 million on its e-commerce business in the last fiscal year. Messier has trimmed costs at money-losing Canal+, while Universal Music has wrung savings from its merger with PolyGram. But despite a leading 22% percent

DANCE OF THE MOGULS

Here's how Vivendi Universal Chairman Messier might choreograph his deals:

JEAN-MARIE MESSIER Would give up Vivendi's 43% ownership of USA Networks Inc. in exchange for full control of USA Networks' entertainment properties.

BARRY DILLER Current USA Networks chairman would get full control of other USA properties such as Ticketmaster, as well as a cash bonus.

JOHN MALONE Cable mogul's European holdings would swap programming with Vivendi's European pay-TV unit Canal+. Malone might even buy Vivendi's 22% stake in British pay-TV operator BSKyB, though that's a long shot because of regulatory hurdles.

Data: BusinessWeek



LIBERTY'S MALONE

market share, Universal Music Group revenues are sagging, and no quick pay-off from Vivendi's online music ventures is likely. Other hoped-for bonanzas from the Net are proving harder to come by. It will be a few years before users of Vivendi's Cegetel mobile-phone unit can download music of Universal artists such

months—hardly an auspicious time to sell. “They seemed to be in such a hurry,” says Edouard Tétreau, chief European media analyst at Crédit Lyonnais Securities. He downgraded Vivendi shares after the transaction, fearing Messier was about to embark on a new round of acquisitions. Tétreau figures Vivendi is already paying nearly \$750 million annually in debt service and now is producing virtually no free cash flow. “It’s no Enron, but it’s a very leveraged company,” he says.

Debt or not, Messier wants a deal, which plays to Diller's advantage. The longtime Hollywood player can afford to bide his time. USA Networks posted 18% revenue growth during the past nine months, with strong earnings from its entertainment business offsetting losses in Internet-related shopping services. Indeed, Diller's main motivation for accepting Vivendi's proposal could be that he's getting tired of Messier pressing for closer ties. “Barry doesn't like people looking over his shoulder, and that's all that Messier seems to be doing to him right now,” a fellow media mogul says. A boffo deal could unwind this relationship and give satisfaction to all concerned. But first Diller has to name his price.

By Carol Matlack in Paris, with Tom Lowry in New York and Ronald Grover in Los Angeles

COMMENTARY

By Chester Dawson

JAPAN: WORK-SHARING WILL PROLONG THE PAIN

Japanese executives will do just about anything to avoid firing someone. They buy people out, they move workers from one unprofitable unit to another, they force them to take less pay. Now there is talk in Japanese boardrooms, union shops, and policy circles of introducing yet another strategem: work-sharing, a concept that has been tried in Europe. It's a tempting idea. Tempting and dangerous.

The notion is deceptively simple: split the work day into more shifts and cut the number of working hours. In Japan, work days are often divided into two 10-hour shifts. This might be replaced with three 6-hour shifts—a cut of four hours per worker. The idea is already catching fire. Ball-bearing manufacturer NSK, carmaker Isuzu, and toilet producer Toto are considering the concept to preserve at least some work for redundant employees. Meanwhile, the finance minister is proposing subsidies to support such programs, while Prime Minister Junichiro Koizumi has ordered up a policy report.

EASING WORRIES. Advocates insist work-sharing will trim costs and save jobs. For starters, they say, companies would no longer have to pay overtime; workers now get time-and-a-half for the last two hours of their shifts. And if companies hired part-timers for the proposed third shift, they'd pay less salary and benefits. Finally, backers say work-sharing will boost domestic consumption. Says Kiyoshi Sasamori, chairman of Rengo, a union that represents 7.6 million workers, from factory hands to civil servants: "Work-sharing will ease worries about job security, encouraging consumers to buy."

There's some faulty logic at work here. To be sure, one reason the Japanese aren't spending more is because they fear job cuts amid record unemployment (chart). But equally



A plan to save jobs will hurt productivity and consumer confidence

critical is the fact that over the past four years, average monthly income has been falling—last year it's down 1.5%—because of pay cuts, shrinking overtime, and skimpier bonuses. Work-sharing means shorter shifts and smaller paychecks, which would only exacerbate the spending phobia.

Creating busywork for idle hands and imposing limits on wages and hours also is sure to weigh on productivity. Japanese manufacturing companies, which already pay a third more for labor than their American rivals and 30 times more than Chinese producers, can ill-afford that added burden. What's more, wages in Japan account for only about a third of the typical big company's per-employee cost. The rest comes from medical, housing, and other

benefits, including such items as discounts for employees at company-owned vacation resorts and stipends for funerals. Union leaders such as Sasamori want these freebies extended to new hires as existing jobs are split up under work-sharing.

Such maneuvering would increase labor costs over the long haul. "Now isn't the time to rush into work-sharing," says Takashi Imai, chairman of Nippon Steel Corp. and the Keidanren business lobby. "The result will be lowered productivity, which simply isn't acceptable."

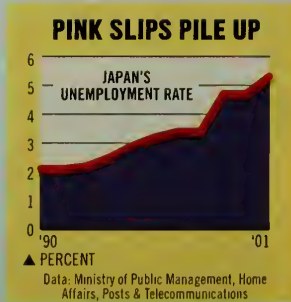
DILEMMA. Finally, work sharing does not address Japan's core dilemma: too many people in the wrong line of work. "Ex-

isting jobs don't need to be preserved, but destroyed," says Andrew Shipley, economist at WestLB Securities in Tokyo. "The problem isn't a cyclical downturn, it's a structural shift." Indeed, while bloated corporations are shedding redundant staff, some jobs in ascending sectors are going unfilled. Demand for computer technicians, health-care workers, and other service staffers will grow even as construction companies go bust and manufacturers move offshore.

Instead of underwriting the status quo, Tokyo should be promoting mobility in the workforce. That means funding retraining and making it easier to transfer pensions when people change jobs. In the longer term, greater competition for labor and

growing tolerance for job eliminations will undermine Japan's cozy workplace traditions. The only way to cure what ails Japan is to stimulate—not stifle—workers' competitive juices.

Dawson covers business and economics from Tokyo.



AN THE SAUDIS STEP N THE GAS?

ans to open up exploration to foreigners have stalled



t was supposed to be a watershed moment. At a private ceremony scheduled for Dec. 16, Saudi officials and representatives from Exxon Mobil Corp., Royal Dutch/Shell Group, and other oil companies planned to sign contracts to tap the desert kingdom's vast natural-gas reserves. A handful of successful deals, expected to yield investments of \$25 billion over the next decade, would signal to the world that Riyadh was serious about opening up its economy. Instead, the two sides are still haggling over basics such as the quality of the acreage on offer and the price of gas. So when they meet, the only documents that will be inked are progress reports on their talks.

Such setbacks are common in multi-billion-dollar energy projects. But if the gas initiative suffers major delays, it is sharply scaled back, the weak Saudi economy will suffer. And the Saudis will miss a chance to repair relations with the West, which have been under severe strain since the discovery of most of the hijackers involved in the September 11 attacks were Saudi nationals. Hopes that the oil-rich kingdom has at long last opening itself up to outside capital could be crushed, too.

GLIMMER OF PROSPECT. The Saudis could use the money. On Dec. 8, the government announced it would cut spending by 10% next year because of lower prices for oil, the source of most of its rev-

facilities to exploit the fuel. The plan calls for petrochemical plants, along with power stations and desalinization plants that will sell their output to local customers. Allowing foreigners to find and exploit gas would be a first since the industry was nationalized in the mid-1970s. The Saudis have tapped the biggest oil companies to participate. ExxonMobil and Shell will head up the

three "core ventures." Other investors are BP, TotalFinaElf, Phillips, and Conoco. Memorandums of understanding were signed in June during a lavish ceremony that featured an appearance by the ailing King Fahd.

PIPE DREAMS

Oil companies contend there may be too little gas

But once they started working out the details, the two sides found themselves far apart. The oil companies contend there may be too little gas under some of the tracts to justify the billions of dollars worth of installations that the Saudis want. They also worry

that it will cost too much to extract the gas from these difficult fields to then sell it to local customers at the 75¢ per million BTU price set by the government. By comparison the U.S. price is \$2.79 per million BTU. The companies would not comment because they have signed confidentiality agreements.

NATIONALISM. The biggest obstacle in the way of an agreement is nationalism. Executives at Aramco, the powerful state-owned oil company, think both oil and gas exploration in the kingdom should be their exclusive preserve. To drive home the point, Aramco recently began drilling on one of the more attractive parcels earmarked for foreign companies. Investors also fret that local electricity and water are now sold far too cheaply for the new plants to pay off. They also say the Saudis have unrealistic expectations about how many people these projects can employ.

To persuade companies to accept lower profits, the Saudis are dangling the prospect of future entry into the far more lucrative area of oil exploration. But investors say that \$25 billion is too high an admission price and demand that all gas projects provide a minimum return on investment of 15% to 18%. Once the fallout from the September 11 attacks subsides, Prince Abdullah may intervene to smooth things out. But he will have a lot of work to do to restore the lost momentum.

By Stanley Reed in London

The Kingdom Plays Catch-up

Saudi Arabia is No. 1 in oil production, but it trails in gas and wants to change that

COUNTRY	PROVEN GAS RESERVES (TRILLION CUBIC FEET)	SHARE OF WORLD TOTAL
RUSSIA	1,700.0	32.1%
IRAN	812.3	15.3
QATAR	393.8	7.4
SAUDI ARABIA	213.8	4.0
UNITED ARAB EMIRATES	212.1	4.0
U.S.	167.4	3.2
ALGERIA	159.7	3.0

Data: BP

enues. The economy could contract by 6% in nominal terms as a result—a scary prospect since unemployment is already at 15%. "This adds impetus for the government to follow through on needed reforms," says Brad Bourland, chief economist at Saudi American Bank in Riyadh.

The gas initiative is Saudi Arabia's best hope of drumming up new investment. Under the scheme, hatched by Crown Prince Abdullah and Foreign Minister Saud al-Faisal a couple of years back, foreign outfits are being invited to develop natural gas reserves and build



ARGENTINA

ARGENTINES DUST OFF THEIR SURVIVAL SKILLS

They're using a vast array of tricks to outwit capital controls

Jorge Blanc has seen it all before. In 1989, the owner of a small camera store in Buenos Aires watched in disbelief as the government seized his entire savings, some \$60,000, and converted it overnight into bonds of dubious value so the bureaucrats could pay their bills. He's not about to be burned again. As Argentina teeters once more on the brink of insolvency, Blanc, 53, is spending his money as fast as he can. He even dipped into his retirement savings to buy \$10,000 worth of developing machines—for customers he doesn't have. "At least this time I'll get something real for my money," he says.

With the government on the verge of defaulting on its \$132 billion debt and the 10-year-old scheme that ties the currency to the dollar under threat, Blanc isn't the only Argentine dusting off survival skills honed during previous crises. For months now, they've been trading in their pesos for greenbacks and stuffing them under their mattresses or spiring their money overseas. A total of \$1.3 billion fled the banking system during a single day in November.

To stop the flight, on Dec. 1, Economy Minister Domingo Cavallo took the ex-

treme step of imposing capital controls. But the new measures could in fact accelerate the outflow, as every account holder attempts to withdraw the maximum amount allowable. "The new limits are more than enough to cripple the banking system," says Christian Stracke, emerging-markets strategist at Commerzbank Securities in New York.

To get around the monthly restriction of \$1,000 per account, depositors opened multiple accounts—until authorities set a limit of two per person. The local press reports that 500,000 new accounts sprang up in early December.

Lessons learned during the days of hyperinflation in the 1970s and 1980s are coming in handy. Despite the recession, domestic sales of durable goods, everything from television sets to cars, are surging as Argentines look to sink their savings into something of enduring value. At Tizado Propiedades, a large Buenos Aires

LONG WAIT: More than 18% of total deposits has fled the bank

real-estate brokerage, the number of property sales in progress is up 60% this month. "People are buying homes out of fear, not necessity," says Guillermo Rivanera, vice-president of Tizado.

ADR GAMBIT. Other schemes require a bit more financial savvy. Buenos Aires' normally sleepy stock exchange jumped 25% in the week following Cavallo's announcement. The short-lived rally was prompted by investors who loaded up on shares in a handful of Argentine blue chips, then converted them into their corresponding American depositary receipts, sold them on the New York Stock Exchange for dollars, and parked the proceeds abroad. Since few U.S. investors

want these shares, Argentines have sold their ADRs at a loss. But apparently those in search of a safe haven for their money are willing to pay a price.

Big business is also having to jump through hoops. To get their cash out of Argentina, local subsidiaries of foreign companies are attempting to prepay debts owed to their parent companies. But all requests for funds to be remitted abroad must now be approved by the Central Bank. Industrias Metalúrgicas Pescarmona, a company that builds power plants, says the added red tape caused it to miss some \$10 million in payments to bondholders in December.

Argentines' coping strategies, of course, are making the crisis worse. Over 18% of total deposits has exited the banking system since July. Cavallo promises that the measures imposed to halt the exodus will last only 90 days. But the three-hour lines stretching outside Buenos Aires banks are a testament to how few believe him. "People here aren't stupid. They know that ones who trust the government are the

ones who get taken for the cleaners," says Christopher Eccleston, an economist at Buenos Aires Trust Co., a local investment house. The disappearance of that trust, hard on over a decade of financial stability, is as important a loss to Argentina as the flight of its money.

By Joshua Goodman in Buenos Aires

ARGENTINE STOCKS STAGE A MINI RALLY



DITED BY ROSE BRADY

IT'S ELECTION TIME, AND EUROPE'S UNIONS SMELL BLOOD

Election season is coming to the heart of Europe, and the Continent's still-powerful trade unions sense opportunity. As France prepares for a presidential race in April and Germany gears up for national elections by next fall, organized labor is stepping up demands for pay increases, shorter working weeks, and better conditions. French bank workers even plan a strike on Jan. 2 to demand more money for the extra work involved in introducing the euro. "We want the government to hear the voice of the labor movement more loudly and more often," says Pierre-Jean Rozet, a board member of France's General Work Confederation.

The rising union activity promises to pose a tough challenge to both French Prime Minister Lionel Jospin and German Chancellor Gerhard Schröder. They will have to decide whether to appease the unions to win their support or to take them on at a time when the European economy is sliding into recession. If the leaders give in, the result could be higher wages, rising costs, and lower productivity, just when Europe needs more labor flexibility.

D MEMORIES. Jospin, facing an uphill battle against incumbent Jacques Chirac for the presidency, is already feeling the heat. On Dec. 4, 1,000 gendarmes staged an unprecedented strike for higher wages and new hires. After four days, Jospin's government agreed to raise their wages by 8% and hire 4,500 new officers as part of a \$220 million settlement. "If the government stops [giving to the unions] here, then it'll be O.K.," says Marc Touati, chief economist at Natexis Banques Populaires. "If they give in to everyone, it will be expensive." French teachers, customs officials, and prison guards are all threatening to strike ahead of the first round of voting in the presidential race on Apr. 21. With its budget under strain, the government can't afford to boost compensation across the board. But prolonged stoppages

would remind voters of the transport strikes of late 1995 that contributed to the downfall of Jospin's predecessor, Prime Minister Alain Juppé.

In Germany, meanwhile, Schröder faces a challenge from the powerful metalworkers union, which controls the shop floors of the all-important auto industry. On Dec. 10, IG Metall demanded wage increases of 5% to 7% for 2002—10 times the forecast inflation rate. IG Metall Chief Klaus Zwickel is threatening to call a strike next spring if employers do not cut an "acceptable" deal in talks due to begin in February. The metalworkers typically make oversize demands early in the negotiating process, and some economists predict the union will eventually settle for 2.5% to 3%. But even that could hit the economy, which is forecast to grow less than 1.5% next year.

WATERED-DOWN REFORMS. While Schröder is not directly involved in labor negotiations, he could call on the unions to exercise restraint, just as he did in 2000. But with the election coming, few analysts expect him to do that. The unions have pulled Schröder left from the centrist path he took earlier in his term, blocking labor market reforms. Meanwhile, since IG Metall sets the tone for other negotiations, a hefty pay raise for metalworkers "could set an example not only in Germany but very possibly in other countries—and not a good one," warns

Gert Schröder, manager of labor relations for United Parcel Service Deutschland Inc. and spokesman on labor issues for the American Chamber of Commerce in Frankfurt.

Indeed, other unions are already acting feisty. Even a modest reform by Prime Minister Silvio Berlusconi has been strongly opposed by Italian unions. It looks like 2002 may be the year of labor in Europe.

By Christine Tierney in Frankfurt and Christina White in Paris



FRANCE: Victorious cops

GLOBAL WRAPUP

THE U.N.'S AFGHAN WORRIES

► Even before the international community's effort to rebuild Afghanistan's economy has started, fears are growing in Kabul that it could be derailed. Leaders of the Northern Alliance are scheduled to transfer power on Dec. 22 in Kabul to a U.N.-brokered transitional government under the leadership of Pashtun leader Hamid Karzai. But some Afghan factions are balking because they feel the new government doesn't give them enough power. And some Northern Alliance military lead-

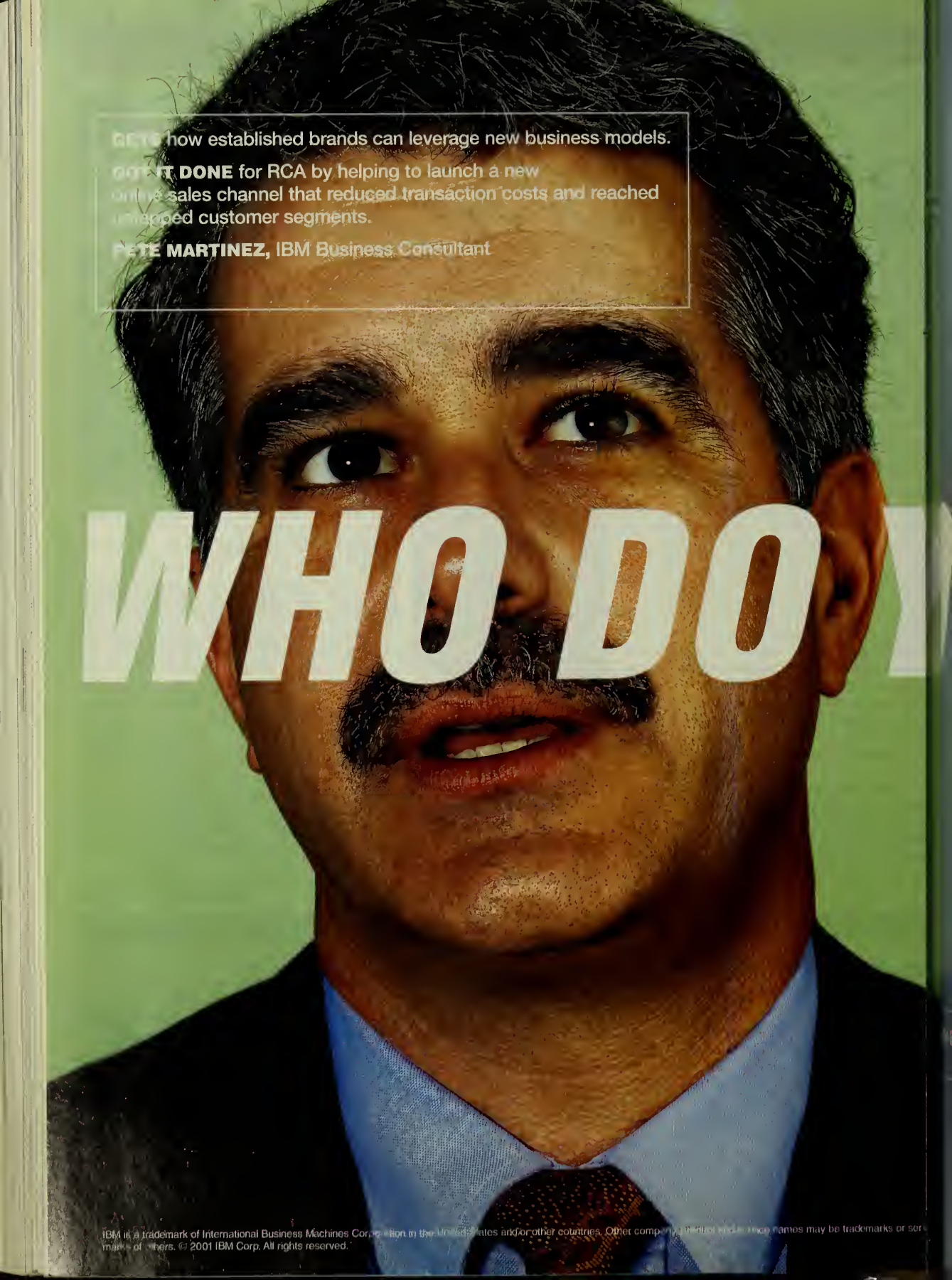
ers are refusing to withdraw their troops from the capital.

That is causing some U.N. officials to worry publicly that fighting could break out in Kabul on Dec. 22 and ignite a whole new civil war. "Afghanistan has been rather in the Middle Ages for some time," says Elaine Duthoit, head of the U.N. Office for the Coordination of Humanitarian Activities in Afghanistan. "I'm quite worried about the future." A U.N. team is currently in Kabul to study humanitarian, infrastructure, and other needs—a critical step before

the international community can begin channeling billions to the country.

There isn't a moment to lose. Winter is settling in over the drought-stricken country, the hills around Kabul are capped with snow, and hundreds of thousands of refugees in the countryside are without food. U.N. envoy Lakhdar Brahimi is aiming to iron out differences with disgruntled military leaders—and pave the way for an international peacekeeping force—so Karzai can form his government and relief funds can flow.

By Michael Shari in Kabul



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GOLF

CAN THE PGA CURE SENIOR-ITIS?

It's scrambling to recharge the languishing Senior Tour

Golfers on the Senior PGA Tour can't match the booming shots of regular-tour whippersnappers like Tiger Woods and David Duval. But for pure nostalgia, what beats the sight of 72-year-old Arnie Palmer hitching up his pants? Lately, though, the Senior Tour has been showing its age. Thinning attendance has sponsors worried. And after an ill-conceived move to CNBC, TV ratings all but disappeared last season.

Against that gloomy backdrop, PGA Tour Commissioner Tim Finchem is pushing a plan to lure fans and keep sponsors. By 2003, the commish promises a new up-close-and-personal Senior Tour featuring players wearing microphones, offering clinics to spectators, and tapping out answers to fans during Internet chats.

"It's going to be different," Finchem says. "In many ways, we'll be a laboratory for change." But are Finchem's fixes enough? There are rumblings that an outspoken group of baby-boomer pros think the proposed solutions are half-measures at best. They're urging the PGA to rethink the tour's over-50 age requirement and open the gates to pros who might move the ratings needle. As it is, most players enter a twilight zone when they hit 45—too old to win on the regular tour, too spry to play with the seniors.

HISTORY LESSON. But would lowering the age limit prevent a Senior Tour implosion? Or is a circuit that was a smash in the '80s and early '90s simply an idea whose time has passed? "The Senior Tour is golf's hula hoop," says Frank Hannigan, a former U.S. Golf Assn. exec who is a golf commentator for ABC.

ment nearly every week from January through October and carved up \$59 million in purses. TD Waterhouse, 3M, and MasterCard, among other sponsors, paid about \$2 million to hang their logos on senior events. And Charles Schwab & Co. sponsors a season-long competition called the Charles Schwab Cup.

Still, Finchem announced that the Senior Tour will drop from about 38 tourneys a year to 32. The commish says seniors will take a breather when Tiger and the regular tour have a major event. But it is also a tacit acknowledgement that the pool of

the dinner hour, was a bust. For so events, ratings plummeted 50%.

The TV problems should ease next year: At the Senior Tour's urging, CNBC will show most tourneys live. But players can't stop selling when the cameras turn off, Finchem has warned. He has stressed to senior pros the importance of cavorting with fans and cozying up to corporate sponsors. "It gets back to the old bottom line: We must open our doors to the people who pay the bills," says Fuzzy Zoeller, who'll be a Senior Tour rookie in 2002.

Doubters remain, however. PGA Tour

NEW WRINKLES FOR GEEZER GOLF

*How the PGA plans to pump up ratings and lure back fans**

- Move telecasts to earlier airtimes, with most events live
- "Mike" players during rounds
- Permit spectators to walk behind the last golfers on final holes
- Encourage on-course interviews during play
- Set up post-round clinics hosted by players
- Offer online instructional Q&As
- Create "honorary observers" program that allows selected fans inside gallery ropes

*Starting in '02; all in place by '03
Data: Professional Golfers Assn.



ROOKIE-TO-BE: Zoeller says players need to be fan-friendly

sponsors isn't as deep as it used to be.

One glaring problem is that the original roster of gallery charmers like Palmer and Gary Player aren't contending for titles anymore. Jack Nicklaus sightings have been rarer since the 61-year-old champ had a hip replacement two years ago. In place of the legends are a group of lesser-knowns who shoot low scores but haven't clicked with fans.

Then there are the tour's TV woes. After a long run on ESPN, the seniors struck a four-year, \$53 million deal with CNBC starting last season. Year One, with most events on tape-delay during

veteran Peter Jacobsen applauds the fan-friendlier Senior Tour. But at 47 and six years removed from his last tournament win, he's struggling to hold his game together while he waits for a second crack at a golf career. Jacobsen has a half-dozen friends—Curtis Strange, John Cook, Jay Haas, Andy Bean, Mark O'Meara—in the same pickle.

"Why would you want to take incredibly valuable assets and put them on the bench for six, seven years?" asks Jacobsen. Sounds like a good question for the Senior Tour chat room.

By Mark Hyman

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Veteran retail analyst Donald I. Trott of Jeffries & Co. didn't become a true believer until he set foot inside the new Toys 'R' Us flagship store in Times Square. Initially, he had a "kind of wait-and-see" attitude about it, he says. For one thing, the cost of establishing the 110,000-square-foot site must have been enormous—perhaps \$32 million for construction, outsiders estimate, plus \$12 million in annual rent. And given the company's many stumbles over the past decade, it was no certainty it could pull off something so ambitious.

But after visiting during opening week in November, Trott is among those cheering. "In my judgment, this will become a must-see," he says, citing attractions such as a 60-foot indoor Ferris wheel and a bigger-than-life animatronic dinosaur. "It's a great store."

GOOD PR. Once upon a time, that would have been enough. But with the chain in the middle of a tough turnaround, it's not clear that Toys 'R' Us Inc. can afford a multimillion-dollar bricks-and-mortar advertisement. Though the company won't discuss the store's price tag, the Times Square site is meant to be emblematic of the changes at the company—of what CEO John H. Eyler Jr. calls "the tangible celebration of a whole new era." But critics worry that the store, which is unlike any other Toys 'R' Us location, will distract management attention from the nascent remodeling of its nationwide stores and efforts to improve customer service and inventory management. That, they say, would be too high a price to pay for some good PR.

There's another reason for caution: The recent history of flagship stores is not encouraging. Tommy Hilfiger has shuttered giant palaces in London and New York. Warner Bros. Inc. is exiting retail entirely after closing a six-story Fifth Avenue cartoon wonderland last year. Manufacturers that opened some of the splashiest emporiums have real-

RETAILING

A SHOWSTOPPER ON BROADWAY

But will the Toys 'R' Us flagship pay off?



THE TIMES SQUARE STORE'S FERRIS WHEEL

ized the money-draining ventures haven't done as much for their brands as they'd hoped.

Those stores were born of the 1990s rage for supersized, bells-and-whistles showcases. The goal was to create a "destination" store—such as FAO Schwarz in New York or Recreational Equipment Inc. (REI), the mecca for the outdoorsy set near Seattle—that customers visit just for the fun of it. They served as three-dimensional ads for the brand. But for a national chain like Toys 'R' Us, the payback isn't as clear. "What is that

store really going to do for Toys 'R' Us?" asks New York consultant Howard Davidowitz. "Every kid knows Toys 'R' Us. Do you really think they're going to [expand] that brand name?"

If not, then it's very important that the store make money. CEO Eyler, a former CEO of FAO Schwarz, expects the store to turn a profit next Christmas. But that won't be easy. It opened one of the toughest retail environments in years, and fears of terrorism that are keeping shoppers closer to home. Pedestrian traffic sharply down in Times Square since September

BIG BET. Times were better last year, when Eyler signed the 20-year lease. But even then it was a big bet for a chain that has been losing share to Wal-Mart Stores Inc. and Target Corp. Management turmoil and a series of disappointing Christmas sales didn't help. Where the chain's U.S. toy store average \$10 million in annual sales, this kind of investment means the new unit has to ring up an awful lot of Barbies and Lego sets. Overall sales at Toys 'R' Us will fall slightly for 2001, to \$11 billion, says Legg Mason Wood Walker Inc. analyst Sally H. Wallick. She expects profits to be flat.

Nor is Times Square an easy place to do business. Toys 'R' Us has devoted much store space as possible to selling, with none aside to replenish supplies. Everything in the store is on shelves. Deliveries come from a New Jersey warehouse in the wee hours.

Still, the location has scored points with some key groups. Quite a few investors have warmed to it, as they enjoy a 20% runup in Toys 'R' Us stock price this year. "I see the advertising and word-of-mouth value from the store as such a large number that it looks like an excellent investment," says Larry Nygren, a fund manager at Harris Associates. But as history shows, good buzz can only carry you so far.

By Nanette Byrnes in New York, and Christopher Palmeri in Los Angeles

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BLACK: "Women want something that feels real to them"

CABLE TV

'TELEVISION FOR WOMEN': NO ONE'S LAUGHING NOW

Under Carole Black, Lifetime has become No.1 in prime time

Forget wrestling or 24-hour news. The most popular cable-television network in prime time this year serves up sentimental portrayals of women struggling with such issues as infidelity or illness while they're busy being doctors, police, midwives, or politicians. Welcome to Lifetime Television, a 17-year-old network once ridiculed for its saccharine scripts and women-in-peril themes. Thanks to some smart original programming and a more upbeat tone, viewers can't seem to get enough of it. TV advertising analyst Jack Myers describes the network's new identity as less "women in jeopardy, and much more women achieving against the odds." Moreover, advertisers clamor to buy time on the Hearst Corp./Walt Disney Co. joint venture, which reaches 84 million homes, even as rivals beg for sponsors. Says Chris Geraci, a senior media buyer for OMD USA: "It's generating a lot of buzz."

That's bound to please the incoming brass at Hearst, which recently

appointed Victor F. Ganz to replace longtime CEO Frank A. Bennack Jr. next spring. Lifetime is a bright spot for the media giant, which—like its peers—has watched advertising fall this year at key properties ranging from the *San Francisco Chronicle* to *Harper's Bazaar*. And with everything from sagging attendance at theme parks to sinking ratings at ABC, Disney needs the boost, too. Lifetime took in some \$481 million in ad revenues in the first nine months of 2001, a jump of almost 12% over the same period last year, according to CMR, which tracks ad industry trends, while most rivals have seen flat or declining sales. With a strong roster of original drama series, such as *Strong Medicine* and *The Division*, its top-rated shows, as well as homegrown movies on such subjects as delinquent



THE DIVISION: The police drama is a top-rated show

Lifetime on Top

To become the leading cable channel, CEO Black:

- ▶ Tripled the program budget (in less than three years) to beef up original programs
- ▶ Doubled annual marketing dollars to build the brand
- ▶ Revved up public-health initiatives (such as breast cancer awareness and domestic violence campaigns) to create a greater sense of community

Now, Black's challenges include:

- ▶ Lifetime Real Women, a new premium network, which could stretch resources and cannibalize existing audience
- ▶ Rivals such as Oxygen and WE: Women's Entertainment, which are gaining new distribution deals
- ▶ Mainstream broadcasters becoming more attuned to the tastes of female viewers

Data: BusinessWeek

children, Lifetime's revenue should reach about \$715 million this year, vs. \$500 million in 2000.

The network's secret weapon: Carole Black, a savvy, relentlessly upbeat Midwesterner who as president and CEO of Lifetime Entertainment Services has pushed her team and her brand to new heights. Since Black, 58, moved from an NBC affiliate in Los Angeles to Lifetime in New York 2½ years ago, she has tripled the network's programming budget, to about \$300 million for 2001, and doubled marketing dollars, to \$120 million this year. She has also revamped projects dealing with such issues as breast cancer awareness.



STRONG MEDICINE: No four-inch Manolo Blahniks here

MORE RIVALS. So women might marvel that anyone would want to spend an evening watching midwives or yet another *Golden Girls* rerun. Not only women—and men—feeling more choices in the expanding cable universe, but Oxygen Media and WE: Women's Entertainment are among several other networks chasing female viewers. "As the channels increase, you are going to see fragmentation no matter how strong your franchise is," says Derek Baines, a senior analyst at Kagan World Media. Of course, scale is different on cable: A top-rated show might pull in 3 million viewers, whereas a broadcast network hit can garner an audience of 30 million.

Even so, Black seems to have touched a nerve with plenty of American women, and she's pouring big bucks

to original programs to keep that edge. One plus is a crackerjack executive team, which drew talent from Disney and from the ad side of that media giant, ESPN. And instead of pumping out reruns, she has focused her marketing dollars on new movies and shows. By the start of 2001, Lifetime had nudged aside TBS Superstation Inc. and USA Network Inc. to become the highest-rated prime-time cable network. Nickelodeon has the highest ratings for the overall day.)

Of course, creating shows for women can be tough. Some prefer *Sex and the City* or even *Monday Night Football*. Lifetime's "you-go-girl" fare. Black says her audience wants "something that feels real to them." That means no goddess warriors, no hypersexed women, four-inch-high Manolo Blahniks, and no more movies like *Jackie's Back*, a Lifetime original about a fictional pop star trying to make a comeback. It fazed—too much bite for Lifetime viewers, Black believes. Rivals say Lifetime's per-earnest take on life doesn't resonate with younger urban professionals—or a lot of other groups, either. Oxygen and WE each have less than half the reach of Lifetime, but they're gaining distribution. "We're just getting started," insists Oxygen CEO Geraldine Laybourne. Even so, analysts say Oxygen targets a narrower niche with its service-oriented programs, while E!, the rebranded Romance Classics, shies out lighter escapist fare.

STRONG TIES. Still, Lifetime consistently ranks at the top with a cross-section of women over 18—though analysts say it may appeal more to older women and moms. No wonder Black feels the world is ready for more Lifetime: She recently added reality channel Lifetime Real women to Lifetime TV and Lifetime Movie Network. The danger is that a new network could stretch resources and splinter the audience.

Try telling that to Black, a former advertising and Procter & Gamble Co. executive who was recruited by the president of ABC Cable Networks Group, Disney Channel Worldwide, Anne M. Veney. "Nothing was broken," recalls Veney, "but Carole saw the chance to have a much deeper and stronger relationship with viewers." Black says that drew her to Lifetime was "a desire to make girls and women feel wonderful about themselves." Such goals may sound a little precious, but Lifetime appears to be pulling it off so far. With growing competition, staying on top could be tough. Then again, Black and her team know all about achieving against the odds.

By Diane Brady
in New York

GAMING

TURF WAR IN HONG KONG

Online rivals muscle in on the Jockey Club's arena

Lawrence T. Wong should be one of Hong Kong's most powerful men. He is chief executive of the Hong Kong Jockey Club, which operates the city's racetracks and betting shops. This nonprofit powerhouse has long enjoyed a monopoly in a city that—legally and illegally—bet some \$20 billion last year. The Jockey Club is Hong Kong's biggest taxpayer, accounting for 10% of government revenues. And since 1.5% of bet-

While the debate has been going on for a while, things heated up in October, when Australia's Centre Racing began offering online "fixed-odds" betting on Hong Kong horses. For the Jockey Club, this was a serious challenge, since under its system the odds change along with the betting pool until the race starts. By contrast, fixed-odds bets offer the gambler surety: the odds won't change even if the horse attracts a flood of money before race time. In November, Britain's William Hill Organization Ltd. said it, too, would take fixed-odds bets on Hong Kong horse races.

Online betting execs say they're doing nothing illegal. Terry Lillis, founder of Centre Racing, dismisses Wong's rhetoric as "posturing" and says Centre Racing is in the market to stay. Since his customers are betting in Australia, not Hong Kong, Lillis says, "there's no legal way they can stop me."



ting receipts goes to charity, Wong is the city's leading philanthropist, funding hospitals, universities, and other good works.

Yet Wong is feeling mighty insecure these days. Since he took the reins of the Jockey Club in 1996, betting receipts have fallen 25%. Moreover, Wong says, illegal bookmakers are grabbing more of his pie because they pay 15% more on winning bets than the Jockey Club. "We've become drastically uncompetitive," he says. Now, with the economy faltering, Wong is facing new competition from abroad. Bookmakers in Britain, Gibraltar, and Australia are targeting Hong Kong, offering phone or online betting to local gamblers. The way Wong sees it, his overseas rivals are "robbing Hong Kong" because they don't pay local taxes or contribute to charity. For their part, officials fear falling levies on horse racing will hurt government finances.

AT THE TRACK The Jockey Club's falling receipts will hurt government finances

The government aims to try anyway. Legislators want to make it illegal for offshore operators to take bets from Hong Kong. But such a law likely would prompt court challenges.

Wong's assertion that offshore rivals are "stealing our intellectual property" because the races are held in Jockey Club facilities is also on shaky legal ground.

Besides, the Jockey Club is itself angling for bets on events organized by others. For instance, Wong wants the government to legalize betting on soccer. He also wants it to tax bottom-line earnings—what's left after the club has paid winners, donated money to charity, and covered its costs—rather than top-line earnings. That might help protect the Jockey Club monopoly a little longer. But with more overseas operators in the wings, the odds of a return to the good old days are slim.

By Bruce Einhorn in Hong Kong

COMMENTARY

By Pete Engardio

SMART BOMBS, SO WHY NOT SMART AID?

In September 11's aftermath, support for foreign aid is growing. Despite deriding "nation building" as a candidate, President George W. Bush is pledging to help rebuild the economies of Pakistan and post-Taliban Afghanistan. And a U.S. Senate resolution calling for tripling foreign aid over five years is gaining bipartisan support. That's a reversal. While still the world's biggest donor, the U.S. has slashed overseas development assistance since 1990 by 34%. U.S. foreign aid accounts for 0.1% of gross domestic product—the lowest level among industrialized nations.

But now, the challenge is to deploy the increased aid effectively. It's essential to focus aid on "creating the basic institutions needed to bring people into the capitalist system and create prosperity," says Hernando de Soto, founder of Institute for Liberty & Democracy, a Peruvian think tank.

How do you pull that off? First, target rural land reform because that gives poor workers a real stake in the economy. Set up and fund financial institutions that provide micro-credit for small businesses, putting people on the path to becoming entrepreneurs. And distribute aid in a way that encourages corrupt or reluctant governments to cooperate. The big lesson: "If you want to win hearts and minds, make sure aid goes to improving people's lives," says aid expert William Easterly of the Institute for International Economics, a Washington think tank.

MICRO LOANS. Land policy is key. In most developing nations, it's not simply a matter of the poor not owning land. Property rights are often so ill-defined that it's hard for anyone to assert title to land. That leaves the poor without the assets needed to accumulate wealth. Many of the desperate young men lured to radical causes are landless. In Peru, property reform helped un-



PAKISTANI SQUATTERS: *Owning land is an impossible dream for many*

dercut popular support for the violent Maoist group Shining Path. The U.S. learned the same lesson, albeit too late, when in the 1970s it funded land reform in South Vietnam, reducing recruits to the Viet Cong. In Pakistan, where some 40% of people are landless, funds should be used to buy small plots for tenant farmers, says Roy L. Prosterman of the Seattle-based Rural Development Institute and an adviser in Vietnam.

The poor also need access to credit. 'Micro-credit' programs are designed to dispense loans of about \$100 to those without any access to capital. Bangladesh's Grameen Bank, for example, gave loans to 2 million

Asian entrepreneurs, many of them women.

Access to technology helps spur local entrepreneurship as well. Private foundations and companies such as Hewlett-Packard Co. have begun setting up inexpensive computer centers—typically, a dozen work sta-

tions, high-speed satellite link, and solar panels—in villages in Senegal, Costa Rica, and India. Within months, such centers seem to be generating dozens of businesses and bringing computer literacy to people who would otherwise be cut off.

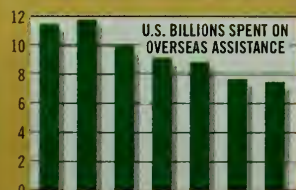
NO LUMP SUMS. Of course, no amount of aid can produce an economic transformation if governments getting the help resist change. During the cold war, the U.S. lavished billions upon corrupt regimes that ignored poverty. Pakistan was a huge recipient, while Egypt got up to \$4 billion annually after the 1979 Camp David peace accord. Yet both remain dirt poor and hotbeds of radical Islam.

To ensure that the infusion of funds heading for Pakistan and Afghanistan are well spent, it is important to rigorously monitor each program and reward real results. Aid should not be doled out at once. It should be gradually dispersed as governments enact reforms or cut off if they don't.

No one says this will be easy. But foreign aid can work if it is well-managed—a lesson Congress and the White House should take to heart.

Engardio covers global economic issues from New York.

THE DECLINE IN U.S. FOREIGN AID



▲ BILLIONS OF DOLLARS
Data: Organization for Economic Cooperation & Development

BUSH'S BUDGET CHIEF STRAPPLES WITH THE NEW MATH

Now, Mitch Daniels has to factor in war, recession, and some unhappy lawmakers

In the early days of the Bush Administration, White House budget director Mitch Daniels sent a clear message to fellow officials by adopting as his anthem the old rock song *You Can't Always Get What You Want*. Now, the man dubbed "the Blade" by resident Bush is learning he'll have to work harder to get what he wants, too.

Daniels' world of number-crunching has been flipped upside down in the last six months. A recession exacerbated by September 11 turned what Bush once called "surpluses as far as the eye can see" into deficits at least until 2005, according to Daniels. What's more, tens of billions of dollars in unforeseen spending for the war on terror and homeland defense have been a big-time budget-buster for a President who promised to hold the line on spending. As a result, the hoped-for 1% cap on spending growth may balloon to 11%. And a huge, back-loaded tax cut could complicate efforts to restore postwar fiscal sanity. Unless the White House and Congress hold the line, Daniels warns, "we will lose touch permanently with balanced budgets, surpluses, and debt reduction."

TRUE GRIT? Tough words, indeed. But Daniels, whose formal title is director of the Office of Management & Budget, will need real grit to reverse the pessimistic fiscal outlook. Some Washington watchers wonder, however, if the blunt, sometimes acerbic Hoosier is the right person for the job. Daniels has alienated some Bushies, and he has raised congressional hackles by decrying the porcine behavior of Capitol Hill. Among those nursing a grudge: House Appropriations Committee Chairman C.W. "Bill" Young (R-La.), senior committee Democrat David E. Bonior (D-Wis.), and the GOP's top Senate appropriator, Ted Stevens of Alaska. The White House is saying there's pork in there, there's pork in there. Like hell there is," thunders Obey. And the situation is likely to deteriorate when the

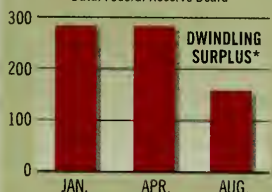
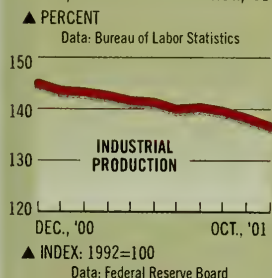
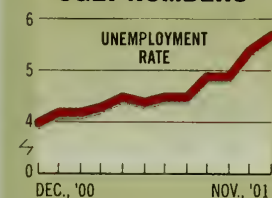
Administration unveils its 2003 budget in February. "Daniels will be trying to pay for those tax cuts [Bush] passed last year by cutting the gizzards out of everything," says Obey.

A newly diplomatic Daniels allows that "I said a couple of things that weren't constructive" and promises to woo "folks that I got sideways with." It might take some doing. Congressional sources say both Young and Stevens

ment adviser on budgetary matters, eclipsing even economic policy adviser Lawrence B. Lindsey and Treasury Secretary Paul H. O'Neill, a former deputy budget director. In the spending debate, "Mitch Daniels is pretty much running the show, to the exclusion of the others," says Representative Robert T. Matsui (D-Calif.), a senior member of the House Ways & Means Committee.

The strength of the OMB director will

UGLY NUMBERS



*ESTIMATES, INCLUDES SOCIAL SECURITY SURPLUS
Data: Office of Management & Budget



CHASTENED: "The Blade" is trying to mend fences on Capitol Hill

sent the budget director a message by "taking their time" before responding to Daniels' apologies.

Despite the dustups, President Bush retains full confidence in Daniels, a former Reagan White House political director, think-tank president, and senior vice-president at Eli Lilly & Co. Although not an economist by training, Daniels remains the President's preemi-

be tested when Congress begins reviewing the Administration's budget blueprint in February. Already this year, a projected \$281 billion surplus dipped to \$158 billion in the OMB's latest estimate in August—and that's before the fallout from September 11. Economists

expect the red ink to start flowing by 2002. In preparation for tough times ahead, Daniels already has met individually with each Cabinet member to deliver a message of wartime austerity. While the White House, in the case of homeland security, "will break all ties in the direction of 'yes,'" other spending requests will be carefully scrutinized, Daniels has warned colleagues.

That doesn't mean a blank check for anti-terrorist initiatives. The Blade promises to slice and dice any agencies that try to slip in new spending in the guise of war-related emergencies. Administration sources say Daniels is scrutinizing "emergency" requests by the Environmental Protection Agency, the Transportation Dept., and the Smithsonian Institution. Case in point: the Smithsonian's \$35 million request to pay for additional security measures at two museums that have not yet opened.

WHIPPING BOY. Some departments already are making plans to sacrifice. The Interior Dept., for one, is considering a plan to outsource half its functions within the next five years. Interior Secretary Gale A. Norton, in a Nov. 26 memo, said 3,500 government jobs will be at stake in the next two years as Interior begins to allow private contractors to compete against the agency for delivery of services. And that's just the beginning if Daniels has his way. He's planning to use the fiscal crunch to push an ambitious reform agenda, including privatization of more federal services, management efficiencies, and consolidation of overlapping programs. One likely target: job-training initiatives. Daniels won't get specific, but other officials predict the Bush budget will boost non-war spending by just 2% to 3%.

Such tightfistedness will further anger Daniels' detractors. Indeed, he has become a whipping boy for critics who are afraid to attack a popular Commander-in-Chief. "Part of the OMB director's job is to be a spear-catcher for the President," says Robert L. Bixby, director of the Concord Coalition, a fiscal watchdog group. "Daniels is exactly the right person to be doing that. But he's thrown a few spears, too."

Despite his vow of civility, Daniels is likely to chuck a few more. This is no time for "business as usual," he warns. And while he is sure to face resistance from bureaucrats and lawmakers, the budget boss says he's willing to risk bruising egos. "Your options are to make the best case you can or throw in the towel before the first bell rings," he says. Ever the fighter, Daniels appears eager for the coming brawl. It looks like it's going to be a bloody one.

By Richard S. Dunham, with Lorraine Woellert, in Washington

The Corporation

STRATEGIES

A GENETICALLY MODIFIED COMEBACK

As Monsanto turns a corner, it sees independence up ahead

Two years ago, Monsanto Co. was a mess. Protests by activists froze the company's biotech operations in Europe and threatened its U.S. business. The company was tottering under more than \$6 billion in debt from buying a slew of seed companies. Its unfocused portfolio included the vaunted arthritis drug Celebrex as well as an herbicide sold to farmers. To top it off, Monsanto had a reputation as an arrogant outfit with no time or inclination to address the public's growing fears about biotech crops. "In the beginning, we said, 'Go away. These are good products. Just accept it,'" says President and CEO Hendrik A. Verfaillie.

Today, St. Louis-based Monsanto has quietly turned a corner in its effort to build a successful biotech business. Under the stewardship of parent Pharmacia Corp., it has spruced up its balance sheet and installed tighter financial controls. More important, the backlash against genetically modified foods is fading as new studies ease fears about the health and environmental effects of such crops, though serious obstacles still retard their potential abroad. And there's a growing appreciation of biotech's ability to feed the world's hungry. Plantings are up, and protests are down. Roughly 90% of biotech crops worldwide contain a Monsanto gene, so the company is well-positioned to profit from this shift.

AUTONOMY AGAIN. And next year, the company will gain its freedom as well. Pharmacia announced on Nov. 28 that it will spin off its 85% share of Monsanto to shareholders in an \$8 billion deal, probably in the second half of the year. That will allow Monsanto to concentrate on agricultural biotechnology without having to win approvals from a parent that is focused on drugs. "If I were [Monsanto] and I were to go to the [Pharma-

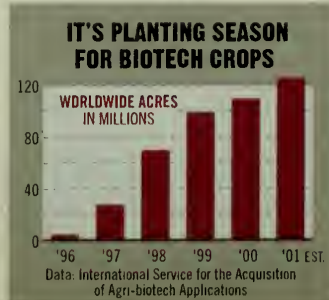


CEO
VERFAILLIE

cia) board and say, 'I want to buy a billion company,' that's probably going to be a tough sell," says Ajay Bansal, a partner in Mehta Partners, an asset manager that owns Pharmacia shares.

Monsanto started getting its act together in March of last year after it was forced into the arms of Pharmacia Corp. in a \$30 billion deal. Pharmacia

integrated the company's pharmaceutical business into its own operation, leaving a much leaner Monsanto that concentrated on biotech and agriculture. Meanwhile, Verfaillie, a 56-year-old Belgian who has run Monsanto since February, 2000, narrowed the company's biotech focus to



as where the payoff promised to be biggest: soybeans, cotton, wheat, and corn, while dropping potatoes, vegetables, and other crops. And he's got the company reaching out to its critics. Wall Street has warned to Monsanto a way that didn't seem possible a year ago. Its shares have soared 75%, to roughly \$35, since Pharmacia listed 15% of the company in October, 2000. And the bottom line is looking better. For Q1, Deutsche Banc Alex. Brown Inc. analyst John Moten expects income to jump 7.9%, to \$475 million, on a 1.6% increase in revenue, to \$5.58 billion. Next year, he expects 5% higher income of \$500 million on a 4.8% revenue increase,

last summer, a United Nations report backed biotech crops, stressing the benefits for the 800 million people worldwide who suffer from malnutrition. The report received widespread publicity and answered critics who argue that biotech helps only big farmers in the U.S. In October, the Environmental Protection Agency approved the sale of a genetically modified corn for seven more years after finding that it posed no risk to humans or animals. This past growing season, U.S. farmers ignored protests by activists and planted 11% more genetically modified seeds from Monsanto. Biotech soybean plantings rose 16%. And 63% of this year's 75.4 million acre

canola, and soybeans, and Roundup Ready wheat is on the way. Each of these new products boosts demand for Roundup. But CEO Verfaillie knows that high-margin biotech seeds rather than low-margin chemicals will propel his company's growth. "It is clear that biotech acceptance is going to be a determining factor in the success of this company," he says.

FRESH PASTURES. Verfaillie sees Roundup Ready seeds as only the start of a parade of biotech products. Monsanto already produces corn and cotton seeds that resist insects in the U.S. and elsewhere. Now it's testing an insect-fighting cotton seed for the huge India market that could be ready in a year. There's also a corn seed going through regulatory channels in the U.S. that resists rootworms. Roughly \$1 billion is spent in the U.S. each year trying to control the pest, making it the No.1 insect problem for corn farmers. Dow AgroSciences and Pioneer Hi-Bred International Inc. are jointly working on a similar product but are not as far along.

Verfaillie's biggest challenge now is to get Roundup Ready soybeans approved in Brazil. Commercial planting of biotech seeds is banned there, though thousands of acres are planted illegally. The issue is tied up in the courts, and Brazilian environmentalists vow to keep it there for years. But the country took a step toward approving biotech crops last summer when it adopted a food-labeling law that laid out rules for genetically modified ingredients. And more than 800 government-sponsored field tests on biotech crops are under way. "Once Brazil goes," Verfaillie says, "then basically soybeans around the world will be Roundup Ready." This is because Brazil is a major exporter of soybeans to Europe, so Europe might have little choice but to accept biotech soybeans.

That may not be as easy as it sounds. Nowhere has the resistance to biotech foods been stronger than in Western Europe. As the intensity surrounding the issue begins to ease, the European Union is weighing a compromise that may lead member countries to lift their bans on new biotech products. But Sue Dibb, a policy analyst at the National Consumer Council in London, says her group's research shows that consumers are still concerned about genetically modified food. "Ultimately, if you don't have consumer confidence, the market isn't going to work," she says.

Indeed, Monsanto still has a long row to hoe in converting overseas consumers. But the prize—a bumper crop of biotech seeds—promises to make it worthwhile.

By Julie Forster in St. Louis, with Geri Smith in Mexico City



VERFAILLIE'S STRATEGY

BIO FOOD

Monsanto is working to gain approvals in Brazil, India, and the EU. And it's planning to introduce herbicide-resistant wheat, rice, and alfalfa and rootworm-resistant corn. Longer term, it wants to commercialize drought-tolerant corn and high-oil soybeans (below).

HERBICIDES

The company is developing brand extensions for its flagship Roundup herbicide and cutting prices to protect market share.

COST CONTROL

It cut costs by \$100 million this year, in part by better inventory management and more focused research and development efforts.

Data: Monsanto Co.



\$5.85 billion. Monsanto has unlocked value, developed a much tougher financial model, and put a sharper focus on cash flow," says Pharmacia chairman and CEO Fred Hassan. "Monsanto's profits are up, and management's self-confidence is up." Biotech critics still warn of the possible dangers of genetically modified foods—they say they might cause illnesses and hurt the environment, and that more tests should be done. But the company seems to be running against them these days, especially in the U.S. A turning point came last year after StarLink, a corn seed approved only for animal feed, found its way into taco shells and other U.S. food. Critics expected an incident to become a rallying cry against genetically engineered ingredients, but consumers just shrugged. Then,

ed in the valuation of the company," says Michael Judd, an analyst at Merrill Lynch & Co. "Eventually, that value will be recognized."

Monsanto can afford to be patient, thanks to the cash being thrown off by a decidedly old-fashioned product. The company gets nearly half of its revenue from its market-dominating Roundup herbicide. The profits from Roundup, which outsells the next six best-selling herbicides combined, fuel Monsanto's \$600 million a year research and development effort. Out of those labs come genetically modified seeds for basic crops such as corn and soybeans that can stand up to repeated dousings of Roundup, which kills everything else green in its path. So far, there are seeds for Roundup Ready corn, cotton,



CARLY'S LAST STAND?

The inside
story of the
infighting
at Hewlett-
Packard

BY PETER BURROWS

As Hewlett-Packard Co. Chief Executive Carleton S. Fiorina prepared HP's purchase of Compaq Computer Corp. last summer, there were already red flags flying. In late July, when HP hired Goldman, Sachs & Co. to finalize the deal, the investment bankers' initial feedback was, "Are you sure you want to do this?" Goldman warned the stock would take a 10% to 15% hit right off the bat because of the massive risk of merging two \$40 billion behemoths with a big stake in the hardscrabble PC business. Then, on Sept. 2, two days before the deal was announced, Fiorina had to tweak her presentation to investors after a Goldman stock analyst warned that her pitch was too optimistic. And all the while, Fiorina knew that board member Walter B. Hewlett, the son of HP co-founder William R. Hewlett, might vote the 5.2% stake he controlled against the merger if Wall Street pounded the deal mercilessly.

The flags didn't fib. The merger news sent HP's stock skidding down 38% over the next two weeks, and Hewlett was true to his word. On Nov. 6, he gave Fiorina only a 30-minute warning before announcing he would vote his shares against the deal. That set in motion a bizarre tug-of-war, as Hewlett and Fiorina both hit the road to convince investors they knew what was best for the Silicon Valley icon. Each claimed they were making headway. Indeed, as late as Dec. 6, the execs were chipper, saying the report being prepared for

the David & Lucile Packard Foundation, HP's largest shareholder, with a 10.4% stake, was positive on how the merger would be executed. But on Dec. 7, Fiorina was dealt a body blow. The Packard foundation said it would oppose the deal, uniting the HP heirs against the merger.

Now Fiorina faces the Herculean task of persuading 67% of the remaining institutional shareholders to vote her way—or face her possible ouster. She has her work cut out for her. In interviews with eight institutional shareholders, *BusinessWeek* has learned that four are leaning against the deal, two will probably support the merger, and two are undecided. The eight hold about 7% of outstanding shares. Still, Fiorina says she can convince investors by the time they vote, which will probably be in March. "We started this because

we think it's the right thing to do. And the foundation's decision doesn't change that," she says. And if she fails? She says she'll cross that bridge if she comes to it. "It is virtually unprecedented for a deal to go to shareowner vote and be voted down," says Fiorina. "If that were to happen, the board and management's credibility would be severely impacted."

In the face of daunting odds, Fiorina remains bold and unflinching—the very traits that brought her and HP to this high-wire perch. Ensnared in an HP conference room on a

Cover Story

THE KEY PLAYERS IN THE HP-COMPAQ MERGER

THE OPPOSITION

WALTER B. HEWLETT



The outspoken dissident. The last remaining board member from the founding families went public with his opposition to the Compaq deal on Nov. 6. Now he's actively soliciting other shareholders to vote against the deal.

DAVID WOODLEY PACKARD



The son of HP co-founder Dave Packard said he would vote the 1.3% stake he controls against the Compaq deal the day after childhood friend Walter Hewlett announced his opposition. His big problem with the deal: It would require 15,000 layoffs.

SUSAN PACKARD ORR



The daughter of Dave Packard and chairperson of the David and Lucile Packard Foundation has been a supporter of Fiorina. But she and the foundation decided to vote against the Compaq merger because of its high risks.

LEWIS E. PLATT



When fortune slowed late 1990s HP's then-CEO made the flashy Fiorina. He of the 12 members of Packard Foundation who voted against the

Saturday afternoon—just 24 hours after she received the Packard news—she maps out why the merger makes sense and why she has doggedly pursued it even though alarm bells sounded months ago. “My words to our board and to the Compaq board was that the market was going to hate this deal initially,” says Fiorina. “The surprises were in degree.” She didn’t expect the stock to drop so far, nor did she expect Hewlett would oppose the merger publicly. She calls Hewlett’s behavior “distracting and disruptive,” and an “insult” to the HP board. Some management experts, however, say that if Fiorina knew Hewlett was wavering, she should have scrapped merger talks rather than risk a damaging proxy fight. “You have to question her business judgment,” says Charles M. Elson, director of the Center for Corporate Governance at the University of Delaware. “Either [the board] failed to persuade him, or they ignored him. Either way, it’s bad.”

“ANALYZING AND ARGUING.” The stage is now set for a soap opera of historic proportions. It pits HP’s top brass against the children of beloved founders William Hewlett and David Packard, who are so revered that to this day their offices are left open and look as they did when the founders were alive—from the funky linoleum floors to the loose change atop Hewlett’s desk. The face-off is sure to strain past and present allegiances: The Packard Foundation’s board includes former HP CEO Lewis E. Platt, who backed the hiring of Fiorina. Richard A. Hackborn, a highly respected HP board member and a former HP exec of 33 years, also is a member of the Hewlett

Foundation. Hackborn says if the deal doesn’t go through he’ll resign. “The board has held many, many meetings analyzing and arguing about this deal. We think it’s the best thing for the company. If the shareholders feel that’s not the case then I’m out of ideas.” All told, these players will wage one of the biggest proxy fights in corporate history—one that could turn especially nasty. One HP executive hints at a possible lawsuit against Hewlett for improper corporate governance. Hewlett’s attorney defends his client’s actions. “What Walter is doing here is the highest example of a fiduciary trying to live up to his duties,” says Stephen C. Neal, a partner in the law firm of Cooley Godward LLP.

Much hangs in the balance. If the deal is scotched, HP could fall into a dangerous limbo as an incoming CEO tries to figure out a fresh strategy. Compaq’s future would be even more precarious. By throwing in its lot with HP, Compaq has signaled that it can’t go it alone. That’s already damaged sales. In the most recent quarter, Compaq’s revenues fell 33%, compared with an 18% drop for HP and a 10% falloff for rival Dell Computer Corp. Compaq insiders say they remain committed to the merger, though they planned to discuss a backup plan at a Dec. 13 board meeting. Compaq board member Thomas J. Perkins says that if it looks as if investors are going to turn down the merger, the boards should dump the deal before it gets to a vote. He thinks the feud is about who will run HP—Fiorina or the families. “This is really a struggle for the soul of Hewlett-Packard,” says Perkins.

THE NEW HP: THE PROS AND CONS OF THE MERGER

Does combining HP and Compaq make sense? Here’s a look at the positive and negative aspects of the deal.

THE POSITIVES

COST SAVINGS HP and Compaq expect the merger to save them \$2.5 billion in operating costs by 2004, largely because of layoffs that insiders say range between 15,000 and 30,000.

FINANCIAL BULK HP-Compaq would have revenues of \$87 billion, putting them neck and neck with IBM for the title of the largest tech company. They would have plentiful cash flow from businesses such as computer repair services, which is expected to generate \$1 billion in profits a year.

CROSS-SELLING The companies will be able to sell their hot products to the other’s existing customers. For example, HP could sell its printers to Compaq’s longtime customers and HP could hawk Compaq’s storage gear to HP customers.

TECHNOLOGY The companies’ technologies complement each other in several areas. HP would be able to build let “always on” systems with Compaq’s super-rapid Himalaya servers, its clustering of ware, which can create as a single

THE SUPPORTERS

ROD A. HACKBORN

The HP veteran, known for building the printing business from scratch, is just a notch below "Dave" in the HP peon. Now a board member, he is a crucial Fiorina ally through his staunch support of the Compaq deal.

LARRY W. SONSINI



The chairman of law firm Wilson Sonsini Goodrich & Rosati has had a critical role in the Compaq feud. In August, he told Walter Hewlett that he could vote with HP's board to buy Compaq, even if he later chose to vote his shares against it.

THOMAS J. PERKINS



The 69-year-old founding partner of venture firm Kleiner Perkins Caufield & Byers sits on Compaq's board. He has become one of the merger's head cheerleaders and has voiced frustration with the HP infighting.

MICHAEL D. CAPELLAS



After taking over troubled Compaq in 1999, Capellas tried repeated restructurings that failed to reverse market share declines and mounting losses. He says the merger will beef up Compaq's key services and high-end computer businesses.

Compaq is a bit in the crossfire. We can only cheer from the sidelines [page 71]."

Fiorina has no doubts about who is running HP and that a merger with Compaq is the best thing for the venerable computer maker. She says that these are just the early days in her campaign to show shareholders just how smart the deal really is. Persuasive detail will be in a proxy statement due out early next year. There is at least one more quarter of financial results from both companies that could improve the picture. And as regulatory approval is obtained, execs will be freer to share the data they have on product road maps, synergies, and cost-savings. "It ain't over till it's over," says Fiorina.

When all this is added up, it shows the potential for a tech titan with clout in nearly every major market, says Fiorina. Compaq's huge storage business would vault HP ahead of EMC Corp. in the fast-growth business. Compaq's robust e-mail servers are popular with corporate customers who want a super-reliable gear. The deal could double the size of HP's computer-repair business, churning out roughly \$1 billion in annual profits. And the pair could take better advantage of the powerful Itanium microprocessor developed by HP and Intel Corp. On top of it all are huge cost efficiencies—some \$2.5 billion a year by 2004. As for the pitfalls of the PC business? Fiorina says cost savings there can turn this, too, into a profitable business. Some analysts agree. "There's a enormous opportunity for synergies," says CS First Boston analyst George D. Elling, who thinks HP's shares

will be worth \$40 if the companies execute as planned.

That's a big "if." This merger would be the biggest in high-tech history. Operations in 160 countries would have to be melded together, thousands of redundant products discontinued, and some 15,000 people laid off. Any missteps could result in losses from the massive \$27 billion PC business that could undercut synergies in other areas such as servers, storage, and consulting services.

TOO MUCH CHANGE? Clearly, HP, the granddaddy of Silicon Valley, will never be the same. Its congenial, egalitarian culture will careen headlong into Compaq's confrontational one. And the increased reliance on commodity hardware will alter "Bill's and Dave's" legendary formula for success. For decades, HP prospered by building the most innovative products—ones that carried the juiciest margins. Only then could they run the company according to the HP Way, a set of corporate values codified in 1957 that gave as much authority and job security to employees as possible. This deal instead casts HP as the No. 1 player in the commodity PC business, which means low margins and low job security. "HP has a long tradition of product development and a long tradition of innovating for the future," Hewlett told *BusinessWeek* on Nov. 6. "We shouldn't try to purchase the past."

If Hewlett plays a leading role in this drama, the central

character is Fiorina—a charismatic CEO, whose irrepressible, can-do spirit could turn out to be her best asset as well as her biggest liability. Experts say her willingness to take radical steps was just the tonic HP needed when its growth stalled during the economic boom. Brought in 28 months ago, Fiorina quickly set out to transform HP into a Web services powerhouse, providing all the gear that corporations would need to do business on the In-

Cover Story

THE NEGATIVES

CHALLENGES

The deal would make HP the king of the PC business, with 18% of the market. Problem is, the business is troubled, with negligible operating margins and no revenue growth. If not run well, losses could mount—and siphon investment dollars from other, more profitable parts of the company.

PCs The deal would make HP the king of the PC business, with 18% of the market. Problem is, the business is troubled, with negligible operating margins and no revenue growth. If not run well, losses could mount—and siphon investment dollars from other, more profitable parts of the company.

COMPETITIVE POSITION

The new HP would be tops in PCs, back-office computing gear, and printers—but for how long? While HP will keep dominating printers, it will be surrounded by rivals better positioned in other areas, including Dell in PCs and IBM in services.

MORALE

Compaq has struggled for years with layoffs and poor performance. HP was struggling to adapt to Fiorina's management changes even before the downturn. Now, the prospect of massive layoffs could send the mood at both companies further south.

ternet. She collapsed 83 units into six centralized divisions, wiping out fiefdoms and creating a more effective selling organization. She scrapped HP's cushy profit-sharing plan in favor of bonuses tied to company performance. And she goosed innovation by creating an incentive program that has doubled the number of patents HP filed this year. That same gutsy style, however, has worked against HP during the past year when the company was juggling too many disruptive changes while trying to grapple with an economic slowdown. The result was missed financial targets and some market-share slippage. "If the economy hadn't gone bad, Carly might be a hero by now," says one recent HP departee. "In the real world, there was just no way all these changes could work out."

And that may wind up being the ultimate irony of this saga. When all the details are spelled out, the merger may make sense. But it has gotten so bollixed up in squabbles with HP heirs and the ferment over changes within HP, that shareholders may shy away because it would mean even more disruption. And what of Fiorina, a self-described "change CEO"? She could become as successful as the master of change, Jack Welch, former CEO of General Electric Co., or she could flame out like Jacques A. Nasser, a CEO who failed to get buy-in for his overhaul at Ford Motor Co. How HP wound up in this place serves as a cautionary tale for any executive trying

to push through big makeovers without first building crucial support. "An out-

sider making change has a lot harder time than someone inside because they have no constituency," says Welch. The GE chairman says he doesn't know whether an HP-Compaq merger makes sense. But, he says, for a board member to vote one way and then reverse that stand is "unpardonable, it's a sin. It's corporate governance at its worst." He says this type of reversal wreaks havoc as employees who hate change think "they can get things back to the good old days."

Brand-new days were just what Fiorina had in mind last spring after she had revamped HP's organizational structure and was casting about for how to supercharge growth. In May, she hired consulting firm McKinsey & Co. to look at strategic options. These included a go-it-alone plan, one that would split the company up, and one in which HP would buy tech-services companies. Some of the options called for potential acquisitions. "Any name you throw at me, we've looked at them," says Fiorina.

DISCOMFORT. HP insiders say Compaq jumped to the fore on June 22. That's when Fiorina visited CEO Michael D. Capellas to see if he would license HP software but wound up talking about a merger instead. From the start, say insiders, HP execs and board members began hashing out the potential pitfalls of the merger. At one Thursday meeting in July, the McKinsey team

FIORINA'S REPORT CARD AT



For decades, HP was a collection of independent businesses, each selling a particular kind of product. Fiorina was hired to execute an "e-services" strategy that would meld these pieces into one powerful, profitable whole. HP could sell everything from handheld gizmos to back-office servers, with the high-margin software and consulting to make it all work.

B The "e-services" plan looks good on paper and may be the right long-term path for the company. But so far, HP is as dependent as ever on its last remaining gold mine: the \$20 billion printing business, which has subsidized losses at the rest of the \$48 billion company for the past three quarters, say analysts.



When Fiorina arrived, there were two companies: a world-class maker of printers and imaging devices and a mediocre computer company. She set out to pump up sales and profitability in the ailing computer business by becoming strong in software, storage, and consulting.

C HP is still the same two companies. It remains the king of printers, the economy downturn has hurt efforts to improve profits in the computer business. The gained market share in Unix servers, but there been negligible progress in storage and software. Consulting remains strong compared with rivals.

work. After studying a slew of deals, they reached this conclusion: Most of the botched tech mergers involved companies that were trying to buy their way into new businesses they knew little about. This deal, on the other hand, could be more like successful mergers in other industries where similar companies combined, such as Exxon and Mobil. "There was a tremendous amount of deliberation," says Larry J. Sonsini, a partner with law firm Wilson Sonsini Goodrich & Rosati, who worked for HP during the negotiations.

And there was action. Two HP board members with ex-



Walter Hewlett gave Fiorina only 30 minutes' notice that he was taking his opposition public

gave board members a thick document outlining the synergies of the two companies. Hewlett, however, was not there. Instead, he was playing the cello in a concert at the Bohemian Grove north of San Francisco—an annual event he had appeared in for the past three years. Hewlett assumed HP would accommodate him, as it had in the past, and save important topics for the board's Friday session, says his attorney Neal. But HP's board plowed ahead, believing Hewlett wouldn't miss such an important session, says an HP insider.

In August, McKinsey went to the next step, laying out how HP might defy conventional wisdom and make a tech merger

experience doing huge mergers—Boeing CEO Philip M. Condit and Sam Ginn, who ran AirTouch Communications when it was sold to Vodafone Group in 1999—helped devise detailed integration plans. These included who would run each of the combined company's businesses and naming an integration office to merge the companies. Other board members developed cost reduction goals for each business. And the compensation committees of both boards worked up bonus plans to persuade key execs to stay on after the merger—to the tune of \$10 million, should all the execs accept.

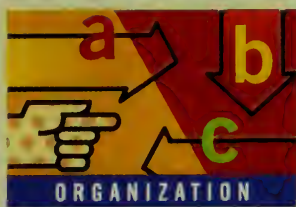
One issue the board did not successfully resolve was

Fiorina came into HP as an agent of change, and the company is a work in progress. A big merger would complicate her task. Here's how she's doing so far:



wanted to update Way, the egalitarian corporate culture that had become cumbersome during the 1990s. She set financial goals, re- profit-sharing with plans based partly on market share, and drove down mandates so HP wouldn't be left behind by its rivals.

Though change was necessary, morale has suffered. And not just because of layoffs are looming. Employees have lost Fiorina's ability to execute her plans. Worse, that her sweeping changes are destroying the company's old culture.



Fiorina shelved HP's decentralized structure for a "front-back" approach designed to make it easier for customers. Rather than 83 autonomous businesses, there are now three sweeping "front-end" organizations that sell the products, and three "back-end" organizations that make them.

D The front-back reorg has created confusion internally, and many customers say they notice little improvement. With responsibility for growth and profits shared between front- and back-end managers, there is less financial control and more disorder. And some promising new technologies aren't getting the support they need.



Fiorina vowed to light a fire under HP Labs and to reestablish the company as a leading provider of gee-whiz new products. The goal was to recreate the success it achieved over the previous decades by pioneering markets from calculators to printers.

B+ Fiorina definitely has pushed up the number of patents at HP. She started an incentive program to pay researchers for each patent filing. The result: Patent filings doubled in 2001, to 3,000, making HP No. 3 in the world. Now Fiorina's HP must prove it can turn those patents into mega-hits with big sales.



Soon after she arrived, Fiorina decided to jump-start the "e-services" plan by buying a big consulting company to help HP move beyond hardware. When her bid for PricewaterhouseCoopers fell apart a year ago, she considered many other options before deciding that Compaq was the best one.

D Fiorina wasn't responsible for the press leaks that hurt PwC negotiations but admits she let talks stretch on for too long. And she had fair warning that the Compaq deal could turn into a mess. HP's bankers said the stock price would fall 10% to 15% initially, and she knew Walter Hewlett was on the fence about how to vote.

Hewlett's discomfort with the deal. "Walter was very vocal in the board meetings," says an HP insider. In an interview on Nov. 6, Hewlett said he was concerned that the acquisition would further expose HP to the PC business, diluting the earnings of its printing business. And one friend with ties to the Hewlett foundation says that Walter Hewlett feared the merger, combined with Fiorina's already radical reinvention of HP, would leave little of his father's company intact. Hewlett's vocal opposition should have been a warning in itself, say friends and colleagues of Hewlett's. They describe him as a liberator, analytical, and slow to make waves. Intensely private, he prefers playing chamber music and duck hunting to playing boardroom politics. "Walter is not the type to try to grab control of a board or twist arms to force his opinion," says former Bell Atlantic Corp. President James Cullen, who serves on the Agilent Technologies Inc. board with Hewlett. HP did make Hewlett comfortable enough to approve the deal. After an August board meeting, Hewlett pulled aside Paul J. Maritz, HP's attorney, for advice. In a 10-minute discussion, Maritz told Hewlett he could vote with the board to O.K. the merger and later vote his own shares as he saw fit without breaching his fiduciary duty to shareholders, says an HP insider. Hewlett never warned HP that he might publicly oppose the deal or declare a proxy fight, says the HP insider. Neal says Hewlett didn't explicitly say he would go public, but "no one had reason to believe he would come out quietly." In hindsight, it's clear HP's board should have gone the extra mile to make sure Hewlett's misgivings wouldn't mush-

room into a public showdown. At the time, advisors to the HP board debated among themselves whether to ask Hewlett to sign a document pledging his support for the deal, say HP insiders. In the end, they decided not to use such pressure tactics. "We didn't want in any way to embarrass the family," says an HP insider. "Instead, we decided to treat him like all other shareholders," and leave him free to vote as he wanted.

When the deal was announced, Hewlett's fears of an investor revolt came true. After the Sept. 4 merger announcement, HP shares plunged from \$23.21 to \$17.70 on Sept. 6, as investors slashed the value of the deal from \$25 billion to \$19 billion. Still, HP's brass didn't think Hewlett would break rank. Indeed, analyst John B. Jones Jr. of Salomon Smith Barney, Compaq's banker on the deal, sent a voice mail to top shareholders on Nov. 5 assuring them that the HP family still supported the deal. HP's execs also believed that. HP board member Hackborn, who sits on the Hewlett foundation, told Fiorina the foundation's stock committee did not plan to decide how to vote until January. By then, HP execs felt they would have swayed investor sentiment in their favor.

LITTLE WARNING. Unbeknownst to HP, Hewlett was making his move. On Sept. 23, he visited the law offices of Cooley Goddard in Palo Alto to make plans. His first step was to ask the stock committee of his parent's foundation to do their own financial analysis of the merger. The committee—which includes no family members, nor general board members such as Hackborn—gave the job to foundation Chief Investment Officer Laurance R. Hoagland. If Hoagland, a former director of Stan-

TO MERGE OR NOT TO MERGE?

Whether Hewlett-Packard ends up combining with Compaq depends on whether HP's institutional shareholders support the deal. Here's a look at the top 15 institutional shareholders in HP and also how much Compaq stock they hold.

	HP STOCK PERCENT OF SHARES OUTSTANDING	COMPAQ STOCK PERCENT OF SHARES OUTSTANDING
CAPITAL RESEARCH AND MANAGEMENT	3.55%	2.84%
BARCLAYS BANK	3.10	3.65
BANK OF AMERICA	2.84	0.22
STATE STREET	2.33	2.04
STATE FARM MUTUAL AUTOMOBILE INSURANCE	2.14	NM
PUTNAM INVESTMENT MANAGEMENT	1.74	4.82
VANGUARD GROUP	1.54	1.53
DAVIS SELECTED ADVISORS	1.44	NM
WELLINGTON MANAGEMENT	1.21	1.00
CITIGROUP	1.18	0.53
TAUNUS	1.15	1.02
AXA FINANCIAL	1.10	0.47
JENNISON ASSOCIATES	1.03	NM
MELLON BANK	1.01	1.11
FIDELITY MANAGEMENT & RESEARCH	0.88	1.01
TOTAL	26.24%	20.24%

Data are the most recent available

NM = not meaningful

Data: Bloomberg Financial Markets

ford University's \$10 billion investment and real estate arm, decided the merger was in the foundation's best interest, Hewlett probably wouldn't vote the family trust's shares against it.

Hewlett, however, accelerated his timetable. Hoagland had planned to make his recommendation in January. With the stock languishing at around \$16, Hewlett told Hoagland he couldn't wait. Hewlett wanted to know quickly whether Hoagland was going to oppose the deal—so he could do the same. His reasoning: If it's a bad deal, better to get it over with sooner rather than later. In early October, Hewlett hired San Francisco investment firm Friedman Fleischer & Lowe to do an

analysis of the merger. When the foundation's stock committee agreed to meet on the subject on November 1, Hewlett asked Friedman Fleischer to have their findings ready that day.

Hoagland and Friedman Fleischer came back with their conclusions that the deal would be bad for HP. Having already hired a press-relations firm to help get the word out, Hewlett called Fiorina to let her know what he was about to do. Just a half hour later, he issued the press release. Why did he give Fiorina a little warning? Inside, close to Hewlett say he was advised not to give her time to get out a press release and frame the issue to HP's benefit. The next morning, David Woody Packard—who had resigned both from the HP board and the board of the David & Lucile Packard Foundation in recent years—announced

he would vote his 1.3% stake against the deal as well. Hewlett felt the massive layoffs that would be brought on by the merger were counter to the HP Way.

Inside HP, the Hewlett and Packard offspring had quickly become a rallying point for the employees who had lost faith in Fiorina's management. In an Internet posting entitled "Walter Hewlett Is My New Hero," one HP'er wrote on November 11 that "he has given me a new energy simply by making his announcement. I pray that he gathers enough support to nix this deal, and hopefully, Carly can be swept under the rug along with it. Thank you, Walter, for standing up for what

FIORINA: THE DEAL IS 'THE RIGHT THING FOR SHAREHOLDERS'

On Saturday, Dec. 8, Hewlett-Packard's Carly Fiorina sat down with BusinessWeek Department Editor Peter Burrows and Senior Editor Kathy Rebello to discuss her effort to merge with Compaq, opposition to the deal, and her tenure at one of the most storied companies in Silicon Valley.

Were you surprised by the decision of the David & Lucile Packard Foundation to oppose the Compaq deal?

Not really. I think the foundation has very particular interests. They are focused, as a foundation, on wealth preservation. And we as a company, and I as the CEO, have to be focused on value creation and industry leadership. In this case, those are divergent objectives from each other.

What do you have to do now to get the deal done?

We keep going. It's the right thing for shareholders. We think it's the right thing for the company. And the foundation's decision doesn't change that. We've done the numbers with and without the Packard vote.

At this point, many shareholders we've talked with are negative on the deal. What will you do to overcome that?

We've got a long way to go on this vote. We haven't filed a proxy yet. We don't have regulatory approval yet. We have at least another quarter's worth of results from both companies. It ain't over till it's over.

It has got to be very upsetting. But you

are very calm. Can you talk to us about how you feel?

You know, the Packard Foundation decision is much less upsetting than some of the unfair characterizations of this company—the lack of a based analysis around the program the company is making, the bias that people have. That is much more troubling to me than a foundation's decision, which I believe was done for them.

What are the top accomplishments of your tenure as HP's CEO?

I think we are much more cost focused. Importantly, customer focused. We are generating intellectual property at a much more rapid rate. So, for example, in the year 2000,



Will Fiorina be a successful agent of change, like Jack Welch, or flame out, like Jacques Nasser?

er Dad and Dave had created." While HP surveys done before Nov. 6 showed that 84% of employees supported the acquisition, that fell to 55% after Hewlett's bombshell. HP Vice-president for Human Resources Susan Bowick concedes that morale statistics are now "lower than we've ever seen them. Employees were really with us until Walter did what he did, but he opened up a flurry of doubt."

HP's brass fumed. Fiorina and board members had been frustrated with Hewlett's habit of missing parts of board meetings. Now they were angered about his going public, and about what they say was an unfair position paper prepared by Edman Fleischer. "It's a misleading advocacy piece," says HP executive. "Walter and David Woodley are acting without integrity in every conceivable way." Early next year, they vow they will refute Friedman Fleischer's findings in detail when they file their proxy statement.

EAT EXPECTATIONS. To win over investors, Fiorina will have to convince them that the deal makes strategic sense and that she can implement it in a company already wracked by turmoil. Brought in as HP's first outside CEO, she quickly launched sweeping reforms that touched every facet of the company. The only problem is, it's unclear whether HP is betting off for the changes. Indeed, some of the market share gains made in Fiorina's first year have begun to recede. While HP continues to dominate the inkjet and laser printer business with 41% share, its PC share has fallen from 7.8% to 6% over the past 12 months. Sales of HP's Windows servers have dropped from 10.6% to 8.2% in the same period. And while HP's share of the critical high-end Unix server business vaulted to 28% in the most recent quarter, up from 23.3% the year before, that puts HP back to where it

was in early 2000, according to IDC. Meanwhile, HP remains an also-ran with single-digit share in soft-

ware, storage, and consulting, says Technology Business Research Inc. analyst Robert Sutherland.

Worse, Fiorina was brought in by HP's board to find new sources of earnings growth, yet HP is more dependent than ever on its last gold mine: printer supplies such as ink cartridges and photo paper. This \$9 billion business churned out \$658 million in operating profit in HP's fourth quarter ended Oct. 31—the third consecutive quarter that it subsidized losses at the rest of the company, says Sanford Bernstein & Co. Fiorina says segments such as Unix servers and computer-repair services are making money. Still, "they're hanging on to profitability by a thread," says Sutherland.

How did this happen after such a promising start? Current and former employees say many of the problems stem from an organization reeling from too many changes. Out went the old system in which 83

product chiefs had their own research and development budgets, sales staffs, and profit-and-loss responsibility. Instead, there would be three "front-end" sales forces, for consumer products, corporate products, and consulting. These would market and sell products made by three "back-end" groups—printers, computers, and tech services and consulting.

At the same time, she cranked up expectations. Fiorina promised 15% revenue and earnings growth in the year ended Oct. 31, 2000. She delivered: Sales jumped 15.4% and earnings rose 15.8%. Such progress ended when tech buying started to drop in the fall of 2000. That November, HP missed the signs and continued to spend freely, while telling Wall Street it would make its numbers. It was only after the quarter had closed that Fiorina realized it was too late to hit the brakes. The result: HP's earnings of \$922 million were 25% below Wall Street expectations. Even then, she didn't take her foot off the gas. She again pledged revenue growth of at least 15% for 2001, and days later told

Cover Story



STEADFAST

HP's boss insists the Compaq deal "ain't over till it's over"

most dramatic tech downturns in 40 years. That's not easy to do.

Why do you think Walter Hewlett opposed the deal after voting with the board in favor of it?

I don't know. There is a big difference between an individual managing his own personal assets and the assets of the foundation and a board member going out and actively soliciting against a board's decision. And I don't know how to explain Walter's behavior.

strategic direction and our competitive differentiation. And I'm also proud of the fact that this company has remained profitable through what has been called one of the

Are you saying you did not know he would go public with his opposition?

Walter's behavior publicly has been a complete surprise. And I think it is an insult to this board.

Conventional wisdom seems to be that you might not remain at HP if this deal doesn't happen. Can you comment?

It is virtually unprecedented for a deal to go to shareholder vote and be voted down. And I think if that were to happen, the board's and management's credibility would be severely impacted.

The board as well?

Absolutely. I do not have a bunch of patsies who sit on that board. They're strong-willed people with minds of their own. I neither could, nor would I, talk the board into something they didn't want to do. This board and this management team are aligned around what we think we need to do.

100 patents, double the rate of 2000. Our imaging and print business remains king of the hill. Even our professional-services are pretty substantially. Our products are better than they've ever been just tied Sun [Microsystems] No. 1 in Unix market share. Now we have a clear view of our



BusinessWeek that talk of a free fall in spending by telecom providers was untrue. "Telcos always say that this time of year," said Fiorina, a former Lucent Technologies Inc. exec who had spent 20 years selling to these accounts.

That earnings slip triggered a cascade of problems. For starters, it caused a 14% drop in HP's stock—which put an end to Fiorina's \$18 billion bid to buy the consulting arm of PricewaterhouseCoopers. While panned at the time, the deal would have been far less onerous than the Compaq merger. What's more, the miscalculation forced management to take cost-cutting actions that were like stomach punches to HP's pampered troops. In December, HP asked workers to take five days of vacation, put off pay hikes for three months, and in January announced it would lay off 1,700 people.

ANGRY WORKERS. Things got worse. When management announced it would need to lay off 6,000 workers in July—less than a month after 80,000 employees had willingly taken pay cuts—the mood of many turned mean toward Fiorina. Management had tried to ward this off by sending out memos, saying layoffs were coming and that volunteering for pay cuts was no guarantee of continued employment. Still, many employees felt duped. And when a staffer shut down an internal message board after the Fiorina-bashing peaked, workers

took it as a sign of insensitivity by their well-paid leader. "Either she has gotten

ten remarkably bad advice, or she's actively trying to anger people," says one employee in HP Labs. A Fiorina backer, he thinks she should have taken a \$1-a-year salary à la Apple Computer Inc.'s Steven P. Jobs and Cisco Systems Inc.'s John T. Chambers, rather than her \$2.9 million in salary and bonus for the year. Throw in the merger layoffs and "it's getting to be like Chainsaw Carly," gripes an HP veteran.

Fiorina's reforms fueled employee confusion. Take the front-back reorganization. On paper, it makes sense. HP's customers no longer have to deal with scores of different salespeople—and those that do call can sell the full suite of products. In reality, though, the new structure is riddled with problems, say more than a dozen current and former employees. For starters, managers accustomed to running their own show now lack the power to deliver on their goals.

REVERED

Co-founders David Packard (left) and William Hewlett created a close-knit culture many workers miss

With no authority to set sales forecasts, back-end managers may not be able to allocate the R&D funds to stay ahead. At the same time, front-end sales reps may have trouble meeting their forecast if their back-end colleagues gin up the wrong products.

JUMP-START? These kinds of problems are a key reason investors worry about Fiorina's ability to execute such a megamerge. It comes down to whether you believe management can pull it off or not," says Kevin Rendino, portfolio manager of the Meridian Basic Value Fund, which owns two-plus million HP shares. "If IBM CEO Lou Gerstner wanted to buy Compaq, I'd give him the benefit of the doubt. But what has she done to make me think she can pull this off? There's not a long enough track record of enough accomplishments."

Fiorina's supporters argue that it's too soon to judge her results, which she always said would take three years or more to pay off. Even Gerstner took five years to transform IBM from a lumbering dinosaur into a limber powerhouse—and he didn't have to deal with the economic downturn of the year. HP supporters point out that only a handful of major tech companies have remained profitable throughout the slump, including Microsoft, Intel, IBM, Oracle, and "Before she became CEO, I was serious about thinking of shorting the stock," says Alan Kent, an HP manager in Richmond, Va. "I think she knows exactly what needs to be done."

The game plan for winning big investors centers on Institutional Shareholder Services, which makes recommendations on proxy voting to many top HP shareholders such as Barclays. HP management will meet with ISS by the end of the year, and ISS is expected to provide an opinion shortly after the proxy is issued early next year. If 50% of votes in favor, HP will then have to win over less than 50% of other shareholders. One wildcard that may play in their favor: Many institutions own both HP and Compaq shares and may vote for the deal on the assumption it would lift Compaq shares more than it would hurt HP's.

The essence of her message to investors is simple: The computer industry will commoditize and consolidate faster than people think. To stay ahead of that curve, HP needs to do a deal now that will give it enough bulk to take advantage of volume sales. She says the two companies can buy \$65 billion worth of materials a year. Execs figure that by combining they can save 1% of that, but she says the number could well be higher—say, 3% or 4%. Execs also believe they can make their PC business more efficient by moving closer to a Dell-like model of selling direct, doing away with the middleman. Compaq is closer to that model and can help HP make the leap. Says Compaq chairman, Ben Rosen: "[The deal] will jump-start both companies in their race for efficiency."

That's assuming the deal happens. Much will be put to the test between now and the shareholder vote—a merger, chief executive, and the fate of one of America's great companies. Massive change is always difficult, and executives either fall on their faces, like Nasser, or become heroes like Welch. Which one Fiorina becomes will serve as a lesson for decades to come.

Contributing: Andrew Park in Dallas, Jim Kerstetter in San Mateo, Calif., and bureau reports

Cover Story

CAN COMPAQ SURVIVE AS A SOLO ACT?

With competition heating up and sales shrinking, investors are losing faith

For three months, Compaq Computer Corp. CEO Michael D. Capellas has been so gung ho about the \$23 billion Hewlett-Packard Co. deal that he has been telling his top executives there's no need for a fallback scheme. "Plan B is e Plan A," Capellas has said.

Now, it's time for a real Plan B. With opposition to the deal coming from members of the HP founders' families, Compaq is preparing for the bleak prospect of going it alone in an industry that has been ravaged by price wars, slowing growth, and consolidation. In a Dec. 7 memo, Capellas told employees at Compaq's "responsibility is to maintain a pragmatic view of our business and a clear focus on the future," no matter what happens with HP. At a board meeting on Dec. 13 in Houston, Compaq's directors were to discuss how to help all investors on the deal and hash out plans should there be a deal. "Obviously at this juncture, Compaq has a Plan B," says Thomas J. Perkins, a Compaq director.

If the deal collapses, the future looks shaky for Compaq. Perkins says the company will remain independent. But going alone after signaling to the market it needed a partner will be difficult. Compaq will have to focus on its best-performing businesses, like Windows servers and storage devices—and shed such poor performers as home PCs and high-end computers that are heavy on technology but light on market share.

Compaq's woes only deepened after the HP deal was announced on Labor Day. The disintegration of the merger, coupled with the effect of September 11 and Typhoon Nari's impact on Compaq's supply chain, pushed third-quarter sales down 33% from the quarter a year ago, to \$7.5 billion. Desktop computer sales fell 42%, and PC server revenue tanked 44%. For the period, Compaq lost \$499 million, including a charge for losses from its investment in the Internet company CMGI. By contrast, Dell finished its third quarter ended Nov. 2 with a profit of \$429 million on \$5 billion in sales, which were off only 10%.

Time isn't on Compaq's side. Analysts have slashed next year's profit targets by 76%, to \$271 million. And sales, expected to fall 23% this year, are pegged to drop 6% more next year, to \$30.7 billion, which would be the lowest in five years, says Merrill Lynch & Co. analyst Steven M. Fortuna. The company is losing market share in key areas such as PCs, servers, and handheld computers, as rivals sow doubts about its future. If the merger with HP falls apart, UBS Warburg analyst Don M. Young says Compaq shares, already at anemic \$9.79, could tumble to \$5, below its \$6.63 book value. The only company that really needs to do this deal is Com-

paq," says Young. "HP has options. Compaq has problems."

One solution may be for Capellas to drop some businesses. Analysts say that if the merger with HP fails, Compaq will have to exit the cutthroat consumer PC business, which accounts for one-third of its \$17 billion in PC revenue. Already, Compaq is evaluating "any and all options," even taking products off retailers' shelves in favor of in-store kiosks and Web sales, says one executive in Compaq's PC business. Capellas declined requests to be interviewed.

UNDER ATTACK. Falling PC profits drove Compaq into the cushier server business in the early 1990s. Today, that business is under attack as well. While PC servers make up one of Compaq's strongest product lines, they have been steadily losing profitability. Late last year, Dell started a price war and by the first quarter was storming ahead in North America, the largest market, with a 32% share according to researcher IDC Corp. Only by slashing prices has Compaq been able to stay close to Dell with a 30% share. But it paid a price: Revenue fell 16% in the third quarter, to \$1.4 billion, even as unit sales held steady. Dell has no plans to call a truce. Says CEO Michael S. Dell: "That's the last place we're going to lighten up."

Capellas can't count on pricey high-end computers to make up the sales shortfall. In the third quarter, IBM's share of total server revenues soared seven percentage points, to

30%, while Compaq's share fell nearly two points, to 14%, according to Gartner

Dataquest. One reason for the gap is that IBM and Sun Microsystems

Inc. are bringing out new high-end servers, while Compaq is phasing out its lineup in favor of new designs from Intel Corp. The new machines won't hit the market until 2004. The move holds promise for Compaq, which has conquered Intel-based server markets before. But if revenue continues to slide, Compaq will have to dump older product lines, analysts say.

Capellas will likely return to his ambitious plan to turn Compaq into a services company à la IBM. On its own, though, Compaq has little chance of getting there. It lacks IBM's software prowess, a key to selling the large integrated solutions, as well as consulting and outsourcing skills that generate big revenues and steady prof-

its. Compaq has a \$7 billion services business, but 56% of its revenue comes from maintenance and support, which only grows as fast as computer sales.

For now, the Compaq board is backing the HP merger. The recent tussling over the deal does not spring from a change of heart on Compaq's part. "It's a deep flaw within Hewlett-Packard," says Perkins. Still, Capellas had better start fleshing out Plan B.

By Andrew Park in Dallas

UNDER PRESSURE

Without HP as a partner, the company may have to drop consumer PCs





THE PENTAGON

KEEPING AMERICA MIGHTY

Despite an impressive victory in Afghanistan, Bush is still pushing for a major overhaul

As a Presidential candidate, George W. Bush painted a bleak picture of the U.S. military. With its inflation-adjusted budget sliced by 27% since the Soviet Union's collapse, the Defense Dept. couldn't afford to modernize its cold war programs—or even pay soldiers enough to keep military families off food stamps. The Pentagon, Bush argued, had to be transformed to fight different wars in the 21st century. And he placed the blame squarely on President Bill Clinton. “The last seven years have been wasted in inertia and idle talk,” the GOP candidate declared at the Citadel on Sept. 23, 1999. “Now, we must shape the future with new concepts, new strategies, new resolve.”

But a funny thing happened on the road to Kandahar. The supposedly tattered U.S. military took a scant two

months to help crush Afghanistan's Taliban regime. The reason: The U.S. military has made great strides in changing itself from a huge, land-based force braced for a massive Soviet armored thrust in Europe into a smaller, smarter, technologically adept fighting machine. From precision-guided bombs to unmanned aerial vehicles (UAVs), the U.S. military wields such power that “the character of war has changed,” says Alexander Saveliev, a defense analyst at the Russian Academy of Sciences.

That has broad strategic implications. Having demonstrated its might, Washington is poised to withdraw from the Anti-Ballistic Missile (ABM) Treaty without fretting about criticism. And through no coincidence, China has abandoned the idea of building an air force or blue-water navy to challenge the U.S.

Yet battlefield success hasn't quelled fierce debates about the military's future. Still pushing for a major overhaul, Bush declared on Dec. 11 that “this revolution in our military is only beginning.” With the political capital Defense Secretary Donald H. Rumsfeld has accumulated as an anti-terror warrior, the

Administration can push toward its goal of even more agile, quicker-responding forces. To get there, though, it has to solve some major questions, such as whether to emphasize long-range bombers over shorter-range jet fighters dependent on nearby basing.

MISSILES OR TANKS? The biggest challenge is to find the right size for the U.S. weapons arsenal. Paying for an expensive missile defense system will probably mean shrinking the number of tanks, planes, and ships. Such cuts would also provide funds to make sure spare parts shortages and other problems don't undermine America's high-tech edge.

A look at potential hot spots suggests that some cutbacks carry big risks. Take the Taiwan Strait. China has little ability to mount an amphibious assault on Taiwan, so it can't do much more than intimidate Taiwan with its missiles. “But you don't control the ground just by launching missiles at another country,” notes former Deputy Defense Secretary John J. Hamre. A Rand study last year found the U.S. could tip the balance in Taiwan's favor by sending just 100 land-based fighters.

two carrier groups, and a dozen heavy bombers.

Similarly, Seoul may not need much help from Washington. South Korea has a well-trained and well-equipped army that would face a North Korean force with primitive weapons, supported by a basket-case economy. "The North Korean military is the most overrated threat the U.S. faces," says Loren B. Thompson, a defense expert at the Lexington Institute, an Arlington (Va.) think tank.

More firepower would be needed if the U.S. faced off with Iraq. It would have to rely on opposition Kurds and Shiites, who aren't as strong as Afghanistan's dissidents. But the Iraqi army is weaker than it was during Desert Storm, so the U.S. wouldn't need the vast force it used then.

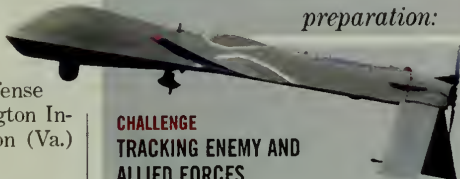
None of this means the Pentagon can afford to stand pat. Most defense experts agree that more money should be poured into unmanned surveillance vehicles such as the Predator Global Hawk. "We have a serious shortage," Rumsfeld told *BusinessWeek* Dec. 4. Predators, some of which carry missiles, can circle for hours and show commanders where both friendly and enemy troops are. Northrop Grumman and General Atomics are the lead in the field, but the Europeans will probably jump in. And Boeing Co. recently created a unit to start making manned combat aircraft.

Precision-guided munitions will be a priority as well. In addition to laser-guided bombs, which clouds can blind, the U.S. is deploying the Joint Direct Attack Munitions (JDAMs), which use global-positioning systems (GPS) to find targets in any weather. It's hard to know exactly how well these bombs have performed in Afghanistan, but there has been some progress. "You can't win a war if you can't hit what you're at," says former National Security Adviser Brent Scowcroft.

Beyond these areas of agreement, however, the Bush Administration will have to make some difficult trade-offs. When the country returns to normalcy, the defense must compete for money

MAINTAINING THE EDGE

The U.S. military has made big strides since the Gulf War a decade ago, as demonstrated in Afghanistan. But fighting future wars will require smart preparation:



CHALLENGE TRACKING ENEMY AND ALLIED FORCES

SOLUTION
Manned reconnaissance aircraft such as the JSTARS should be augmented by drones such as the Predator, which can also fire missiles.



CHALLENGE IMPROVED TARGETING

SOLUTION
Smart bombs such as the JDAM as well as upgraded communications links that relay real-time coordinates on targets will reduce misses.

CHALLENGE NEED FOR RAPID RESPONSE

SOLUTION
Rather than upgrading more heavy tanks, focus on light armored vehicles like the LAV-3 and troop-carrying aircraft such as the C-130J.



CHALLENGE LACK OF ACCESS TO NEARBY BASES

SOLUTION
Cut back on purchases of 2,100 new Air Force fighters. Instead, build more long-range bombers, like the B2, and more carrier-based jets.

with Social Security and Medicare, the Pentagon won't be able to afford upgraded missile defense, new high-tech weapons—and the replacement of all of its aging gear. The Bush team has pledged to junk cold war relics, but has not yet identified a single major weapon to cut. Indeed, the Pentagon still plans to spend \$340 billion on 3,700 manned fighters: Lockheed Martin Corp.'s F-22 Raptor and Joint Strike Fighter and Boeing's Superhornet.

Many experts question whether all of these are needed. The accuracy of precision-guided munitions means fewer sorties are required to destroy a target. And the Air Force is slated to acquire thousands of new fighters at a time when access to land bases is increasingly problematic. In Afghanistan, bombers and carrier-based planes did the work. "Putting all this money into three tactical air programs seems crazy to me," says Michael G. Vickers, director of strategic studies at the Center for Strategic & Budgetary Assessments.

On the other hand, the Pentagon cautions against extracting too many lessons from Afghanistan. In the earlier Kosovo conflict, Air Force fighters pulled the load, notes General John P. Jumper, the Air Force Chief of Staff. Adds Rumsfeld: "It would be a mistake to look at Afghanistan and think of it as a model that would be replicated."

TRADEOFF. Indeed, if Afghanistan proves anything, it's that we don't know what the next threat will be. That's why some defense analysts are urging the military to hedge its bets. It could, for example, buy a smaller fleet of land-based fighters than it originally planned, and spend the money that it saves on bombers and carrier-based planes, which don't depend on the kindness of neighbors for bases. Some in the Pentagon want to develop a new bomber or have Northrop Grumman restart the B-2 bomber production line. Air Force brass balk at both options, fearing new spending on a bomber would come at the expense of the F-22.

As powerful as Rumsfeld is in the flush of the Afghan war, this sort of resistance from the services will make it hard for Bush to achieve a radical transformation of the military. But the Pentagon will evolve regardless. Candidate Bush underestimated this in 1999—and so have many of America's foes. But it is something they underestimate at their peril.

By Stan Crock in Washington, with Stanley Holmes in Seattle, Dexter Roberts in Beijing, and bureau reports

LOGISTICS

THE MARINES LEARN NEW TACTICS—FROM WAL-MART

To fix its supply chains, the Corps studied the private sector

The Marines knew they had problems. Four years ago, when a soldier at Camp Pendleton near San Diego would put in an order for a spare part, it took him a week to get it—from the other side of the base. Worse, the force had 207 computer systems worldwide. Referred to as the Rat's Nest by Marine techies, most didn't talk to each other, meaning soldiers would have to resort to phone or fax to place orders, leading to errors and lost time.

Private companies, meanwhile, were greasing their supply chains to provide just-in-time delivery, and the Marines knew they could do better. So the Corps sketched a 10-year tech strategy in logistics, to ensure that 173,000 marines have what they need when they need it, without having to ship tons of supplies closer to the battlefield. To execute, the Corps hired consultants and studied companies like Wal-Mart Stores Inc. and United Parcel Service Inc. And as the war in Afghanistan loomed, it redoubled its efforts. "We're in the middle of a revolution," says Lt. General Gary S. McKissock, deputy commandant of the U.S. Marine Corps for installations and logistics.

Victory will come when a smooth flow of information allows troops anywhere to get supplies within 24 hours, says McKissock. He also aims to reduce inventory for the Corps by half, save up to \$200 million, and shift 2,000 marines

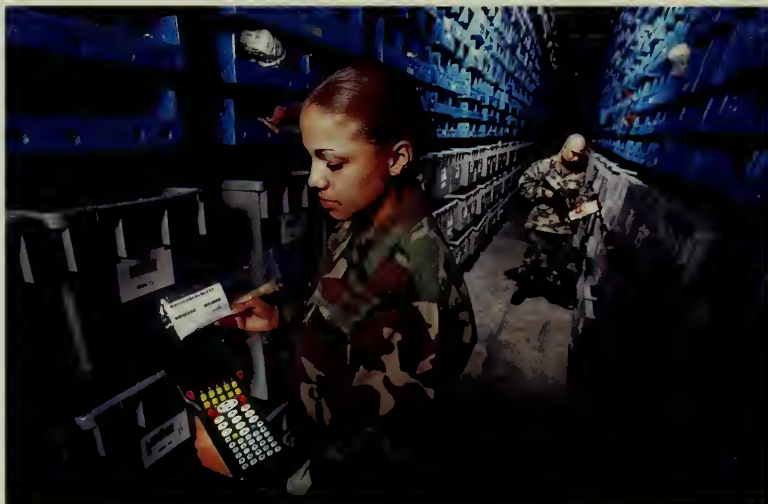
from logistics detail to the battlefield by 2004. By replacing inventory with information, the Corps won't have to stockpile tons of supplies—the so-called Iron Mountain—near the battlefield. That's what the armed forces did during the Gulf war, only to find they couldn't keep track of what was in containers and didn't even use many of the items.

After hiring consulting firm Sapient

everything. Sapient advised that there was no need to overstock commodity items like office supplies that can be obtained easily anywhere. Taking a page from Unilever Group and Swissair, the Corps is developing better relationships with suppliers to make sure they have access to harder-to-get items like spare parts. And with advice from Caterpillar Inc., the Marines have been upgrading warehouses, adding gadgets like handheld wireless scanners for real-time inventory placement and tracking. Realizing they could do without the 602 supply "was like a 2-by-4 to the head," says Jim Forrest, a director at Sapient.

LAN LINKS. To be sure, it will take a few more years to figure out what works, trim some of the 207 IT systems, tie the remaining ones together, and tie it all out to the entire force. In the year, the number of systems has been cut by 20%. Next, those will be combined into 30 to 50 systems.

KEEPING TRACK: Marines now use handheld scanners



linked systems. Marines will know instantly what parts are available where.

Meanwhile, the tech improvements since the Gulf war are already helping in Afghanistan. If containers need to be sent in, they will have radio frequency

transponders which, when scanned, will link to a data base detailing what is on the side. That way, there's no risk of parts being lost along the way. And to get supplies more efficiently, the Corps will employ mobile local area networks that can plug into a master supply network. If a marine orders more blankets, they'll get a reply on when they'll arrive. They'll be flown in from the closest supply point, probably a ship in the Indian Ocean. Ship stocks will then be replenished from the base warehouses. It's not quite just-in-time, but it's closer.

By Faith Keenan in Baghdad

TAKING A PAGE FROM RETAIL

How the Marine Corps can cut inventory in half and save \$200 million.

LESS STOCK

The Corps is stockpiling fewer readily available items such as office supplies, boots, and other goods.

MODERN WAREHOUSES

Warehouses will sort and retrieve goods automatically, while handheld computers help track inventory.

SIMPLIFIED TECHNOLOGY

The Corps' entire logistics network could run on just 30 computer systems, down from about 165 today.

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SOFTWARE THAT SNIFFS OUT STOLEN PROPERTY

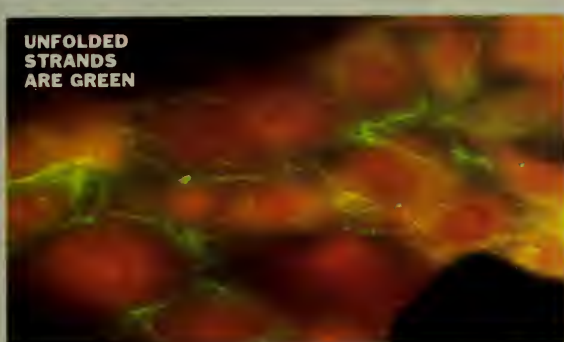
STOLEN POWER SAW HAS LED to a promising new approach to solving property crimes. In July 1999, Vancouver police found a Skil circular saw in a pawnshop. Scratched on the blade was a driver's license number, which led cops to the original owner: Duane Nickkull, co-founder of startup XML Global Technologies.

Nikkull and CEO Peter Vandro were shocked, however, to hear of the police's high-tech methods for investigating thefts. Second-hand stores and pawnshops in Vancouver send in 400,000 reports each year on the items they purchase. The reports are on paper, so finding matches with goods that have been reported stolen is a time-consuming task and is often undertaken for high-profile crimes.

Working with the Vancouver police, XML Global developed a better approach. It's a system called Xtract that uses XML, a fast-proliferating Internet language. Second-hand stores enter descriptions of each item they sell into a police database over a secure Internet connection. Then the software instantly scans the entries for details that match descriptions of stolen property—a process that used to take weeks with paper records.

Xtract is already paying off. In December, police used it to nab a jewelry thief and recover \$12,000 worth of loot. "We would never have been able to do that before," says Sergeant Doug Fisher, head of the city's property crime unit. The city is paying a subscription fee of \$74,000 a year for the system. And XML Global is negotiating with other police departments in Canada as well as the U.S.

John Carey



SHEDDING LIGHT ON PROTEIN FOLDING

PROTEINS ARE NOTORIOUS SHAPE-SHIFTERS, CURLING AND uncurling like serpents as they go about their work in and around living cells. The changes in shape are important because they affect the way proteins function. Viola Vogel and colleagues at the University of Washington have now devised a way to dye proteins to determine their shapes on and around living cells.

The dyes are made up of tiny molecules that are excited with a beam of light and can then swap energy with one another if they are close together. Some of the molecules are donors and others acceptors. When an excited donor transfers energy to an acceptor, the acceptor emits red light, but if the donor cannot transfer energy to an acceptor, it gives off green light. When the protein is tightly folded, many donors are close to acceptors and energy passes between them, producing a red glow. When the protein is stretched out, donors and acceptors are far apart, so the dye glows green.

The image above shows a protein called fibronectin, which helps hold cells together. The green highlights from the dye show that the molecule is stretched out. Vogel says this is the first technique to reveal protein shapes in cultures of living cells.

Paul Raeburn

UNLOCKING THE BRAIN'S MYSTERIES

SOMEDAY, THE HUMAN BRAIN might be programmed almost like software. Researchers at the University of Texas are working on a method of sending signals directly to specific brain cells. Once perfected, the technology could control all kinds of brain activity—triggering neurons to release dopamine, say, in patients suffering from Parkinson's disease.

The process uses tiny cadmium-sulfide-based semiconductor particles paired with

miniature proteins, or peptides, that have molecular "keys" on their surfaces. The particles are so small—a mere 0.0000045 millimeters in diameter—that they could wander through the brain until each peptide key finds its matching lock on a neuron.

Currently, the team makes the lock-and-key connection in lab cultures, then communicates with the brain cells via pulses of light. Next, leader Christine Schmidt, an assistant professor of biomedical engineering, wants to catalog neuron responses to signals. As for real-world applications, they're a decade in the future.

Darnell Little

INNOVATIONS

■ Soon you may be able to clean plastic lenses of eyeglasses and cameras with steel wool—and make nary a scratch. Germany's Fraunhofer Institute for Applied Optics & Precision Engineering has developed a lens coating that's almost as hard as diamond, yet cheaper than existing scratch-resistant coatings. It's composed of alternating layers of a special polymer and thin films of titanium and tantalum oxide.

■ Beware of noisy toys for Christmas. The American Speech-Language-Hearing Assn. warns that some toys produce sounds so loud they can cause permanent hearing loss in youngsters, especially when kids hold a noisemaker near their ears. Be particularly leery of toys with sirens and horns, the group advises, but some clickety-clack cranks and even squeaks from squeezable toys may harm hearing as well.

■ Myrrh, one of the gifts presented to Jesus by the Three Wise Men, may contain a potent anticancer agent. Researchers at Rutgers University say the compound, which may inhibit a protein involved in tumor growth, is particularly effective against breast and prostate cancers. While myrrh capsules and teas are already found in health-food stores, it will take at least five years to develop and test a commercial drug.

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BACK TO THE CITIES

The revitalization of the American city has been gaining in coherence and momentum during the past decade - and it continues apace, even as New York labors to clear the rubble and sets about healing its great wound.



Underpinning the process of urban revitalization has been the insight put forth by Michael Porter, Harvard professor and founder of the Institute for a Competitive Inner City, that the greatest underdeveloped and underutilized market in the United States is its inner cities. "If you look at the inner city not as a social problem, but as a potential economic opportunity, you find it has very big advantages as a business location," he explained at a 1994 conference sponsored by the Ford Foundation. These include logistical infrastructure, land availability and convenience for delivery; large markets for consumers and for business; ample and available workforce; and a central location from which to serve the national economy.

"What we're seeing," in Porter's view, is a reversal of the long-term spread into the suburbs. We're seeing that the more efficient place to do business today is in the central core city."

The Ford Foundation has embraced this with enthusiasm. "There was a time when America's corporate leaders viewed low-income communities and the people who live in them primarily as the beneficiaries of philanthropy,"



observed Foundation President Susan V. Berresford. The new movement among businesses is "to go beyond corporate giving, and to invest in opportunities emerging in overlooked markets," which are "transforming themselves into some of America's most competitive places to do business."

Ford is supporting a network of business and community-development intermediaries that provide research, information, and strategic advice to corporations and business leaders - and facilitate deal making.

SUCCESS STORIES

■ **Pathmark Stores** found its investment in a 44,000 sq-foot store as an anchor to a new shopping center in Newark's Central Ward so successful - second in sales in its 144-store chain - that it has opened a new supermarket in Harlem.

■ **Sears Roebuck and Target** are both tapping the fast-growing Hispanic market in East Los Angeles. Each retailer is enjoying in-store sales well above their national averages.

■ **Bank of America** is cooperating with the National Assistance Corporation of America in a \$3 billion, 10-year outreach program to attract prospective buyers from targeted neighborhoods. They attend a mandatory 10-week training program in order to qualify for a no-down-payment mortgage at market-level interest rates. The bank has already provided \$150 million in home mortgages to 1,400 families in Atlanta, Baltimore, Washington and Charlotte.

■ **Eaton Corporation** decided not to leave a declining sector of Milwaukee, but to stay and rebuild the local neighborhood where its roots are deep. It joined with the Northwest Side Community Development Corp. to recruit entre-

preneurs to the area to provide customized products for Eaton's special needs, developed a community-based crime prevention program, and created a school-to-work program that teaches job skills and sends 60 percent of its graduates on to college.

■ **Chevron** has collaborated with Oakland's Freedom Fund to help reduce crime at inner city gas stations and increase sales through better public safety. It recruited and trained inner-city residents to run a marginal, crime plagued gas station, where crime has been cut to almost zero, and sales have gone up by 200 percent in three years. Freedom Fund has since bought a vacant lot with two abandoned liquor stores, and leased it to Chevron, which invested \$1.6 million to build its largest station in the city.

PSE&G - PRE-K THROUGH POST-12

Intense concentration for years on every aspect of urban revival has led PSE&G, Newark's giant utility, to turn to upgrading the city's labor pool as the best way to keep on gaining.

At the same time as New Jersey launches a statewide pre-school program, PSE&G is embarking on its own broad program of leadership, organization, and subsidy in order to extend the educational experience of Newark's children beyond graduation toward work - so, in time, the city's educational system will come to encompass both pre-K and post-12.

The corporation has learned much over the years through its deep involvement in the rebuilding of a single neighborhood. It has gained experience working with and supporting faith-based institutions, social services agencies for children at risk, programs to encourage and subsidize affordable quality housing, and community health. Its real estate development efforts helped build two efficient warehousing businesses in a previously run-down neighborhood.

As Newark benefited from an influx of capital into new civic centers and downtown revival, "one of the things that has become real obvious," observes Al Koeppe, President and COO, "is that without jobs, it doesn't matter how many great new spaces you build. People need to work.

"One of great things about the renaissance of Newark is that there will be opportunities for people who have the willingness to work. One of the great challenges for us is to make sure that they have the training to work in the skilled trades - iron workers, really good brick and mortar workers, electricians."

THE BOOMERS ARE AGING

PSE&G actually has no choice, Koeppe emphasizes. Of the 6,000 people in his division, 3,000 work outside the main office. "They are skilled, very skilled. But they are also getting older. The boomers are aging. What has hurt us in the past was the inability of our high school seniors to find that kind of employment.

"So we are reaching out to them, meeting with the senior classes and telling them that we are interested in bringing minority and diverse candidates into the outside-plant end of our business, that there are well paying, stable job opportunities there. We are telling them that there are opportunities for higher educational assistance in the form of subsidized work programs. We are also helping them pass skill tests - and providing mentoring once they are here so they won't leave us. It is active recruiting in the inner city."

Looking ahead toward further enrichment of the labor pool, Koeppe emphasizes the need to attract good teachers to the inner cities and to retain them. Teachers do leave the inner cities - they get good and they leave. One way "to crack that code," he suggests, is for private industry in concert with the state "to create opportunities for teachers to get specialized knowledge and

training from institutions like ours, to find a way to give them something extra, to advance their careers. That's what we are looking for the future."

PFIZER - DIAMOND IN THE ROUGH

Most examples of revitalization are modest in size and incremental in effect. Such, however, can be enormous in their immediate impact and long-term contribution to a city. Such was the decision by pharmaceutical Pfizer Inc. to build its \$308 million Global Research and Development headquarters on a 22-acre brownfield site in downtown New London, CT.

At 1.35 million square feet, on a campus of three six story buildings overlooking the Long Island Sound, the new research complex is projected to create 2,040 new jobs. By 2004, increase the city's tax base by 15 percent and spark an increase in personal income of more than \$500 million by 2009, from less than \$100 million today. In a city of only 24,000, this takes the art of city revitalization to new heights.

When Pfizer came looking at New London among some 200 sites it was considering, it found "a diamond in the rough," in the words of the city's development chief, David M. O'Brien. And New London was ready. It had suffered some deterioration in services over the years as manufacturing moved out, but had kept its basically sound social and educational infrastructure. The city had been disappointed at least three times on projects to build the site Pfizer eventually bought, so it was in a position to accept the Pfizer offer on very short notice. "You can usually measure the time to development on this scale in decades," observes Daniel O'Shea, Global Research and Development Vice President for Operations and Public Affairs. "We took about a month to open up our minds, and in two and a half years we were in business."

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BROWNFIELD OVER GREENFIELD

In a city of obviously large revival potential, brownfield was a clear choice over rural greenfield sites that lack the healthcare centers, the restaurants and theater district, and the educational system. The community's educational potential was such an important issue in the full decision that O'Shea reviewed the SAT scores from all the sites being considered. O'Shea explains, "while New London might no longer have held its once very elite position, the structures are certainly there, and we believe we can help catalyze the transformation of some of them."

The move into New London has already energized a cluster of small businesses and is expected to attract more. Printers and data entry services have set up shop. Construction and related businesses, of course, are doing well. And, O'Shea believes, "in time there will be other bio-tech types of companies that will make their way here."

One unexpected new arrival has added \$20 million to the cost of the building. When Pfizer acquired Warner Lambert in June 2000, 29 months after the project was first announced, the company's research staff grew from 7,000 people to more than 12,000 worldwide. Underscoring its commitment to New London, Pfizer simply added two more floors to accommodate many of them, O'Shea recalls. "In this business it pays to be nimble. And a little bit lucky."

NEW YORK'S COMEBACK

New York City and State have demonstrated resiliency in the face of unprecedented adversity. The attack against America and destruction of the World Trade Center, on September 11th, may have left devastation in its wake, but it also gave birth to a spirit of unity that has rallied America and the world

around New York. The outcome will be a city and state stronger and more competitive than ever before.

New York State has received national and international acclaim as a leader in new business investments and expansions. Over the last seven years more than 709,000 jobs have been created.

Since 1995, under the leadership of Governor George E. Pataki, New York has cut taxes more than any other state - 19 different taxes have been cut 57 times for a savings of over \$100 billion when fully implemented by 2005. Over 1,800 regulations have been streamlined or eliminated. Workers' Compensation costs are down more than one third, saving New York businesses over \$1 billion annually. The state's corporate tax rate is approaching the lowest level since 1970. The state eliminated the gross receipts tax on energy for manufacturers and industrial energy consumers.

In the aftermath of the WTC disaster, New York's strong city and state leadership has inspired confidence in both citizens and investors alike. From providing office space to displaced companies, extending tax deadlines, directing low-cost power to WTC businesses, earmarking cash grants to provide immediate help, to launching an unparalleled tourism campaign, the city and state have been responsive to the unique circumstances of residents, businesses and tourists.

In other cities around the state, revitalization continues with state support through Empire State Development (ESD). Its innovative Empire Zones, with tax benefits allowing, in certain locations, businesses to operate virtually tax-free is a popular incentive program.

KEY CITIES

■ In the **ALBANY** area MapInfo is investing more than \$18 million in the development of its new 210,000 square-foot headquarters and plans to add 400 new jobs.

■ In **BUFFALO**'s Towanda suburb, General Motors is investing \$500 million in its new 600,000 square-foot Vortec inline engine plant, the most technologically advanced plant of its kind in the world.

■ **ELMIRA** converted a former General Electric foundry into Trinity Industrial Park, where seven businesses have invested more than \$10 million. Public and private investors have put \$15.5 million into the Coach USA Center for sports and entertainment complex.

■ **PLATTSBURGH** created a major opportunity from the closing of its air base in 1995. The base Redevelopment Corporation brought more than 60 tenants, including subsidiaries of Bombardier, and Pratt and Whitney. Net new jobs: More than 1,000 new jobs.

■ **ROCHESTER**, optics and imaging capital of the world, has experienced a boom in semiconductor manufacturing and services, with major expansions by Heidelberg Digital, Paychex and Citizens Communications.

■ In **SYRACUSE** Bristol-Myers Squibb is planning an expansion of its Center for Biotechnology Development with an investment of \$10 million and the creation of 60 new jobs.

Before the disaster, NYC had compiled its best economic record in half a century. "Businesses wanted to invest here," said Stephen Kagann, Chief Economist to the Governor. "Crime was way down, the city was clean and packed with tourists and young people came to start careers. The same sound steps will be used in the rebuilding process - keeping taxes down, services effective and the climate conducive for business," he said.

According to Kagann, the state's message is clear and its promise resolute. "The impact from the disaster was historic, but it will be our comeback." For more information visit www.nylovesbiz.com ★

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The High Country Goes Down-Market

Colorado ski resorts slash prices to lure travelers



Keri Standifer of Southlake, Tex., had planned to save money by driving instead of flying to the Keystone Ski Resort for the Martin Luther King Jr. weekend. She was willing to book cheap lodging outside Keystone, too. But the Standifer family is flying to Colorado, and they'll stay at Aspen Ridge, in the heart of the resort. Its \$2,500 package for Standifer, her husband, and their three children includes airfare, 100 nights of lodging, and four days of skiing. "We get to do everything—fly, stay in the resort, and ski—for a long time," says Standifer—who estimates she's paying \$1,500 less than the rates last year.

—not the only one discovering bargains in the Colorado high country. A slowing economy and fear of flying in the wake of September 11 caused pre-season bookings to fall 10% to 20% from last year's level. In mid-October, they were off about 23% at Vail. Things have picked up somewhat because "people live stressful lives and they need a vacation," says Martin White, a Vail senior vice-president. Still, he adds, "nobody wants a deal."

You'll find those deals even for Christmas, a magical time in snow country. Skiing Santas don't eat cookies and hot chocolate or cider, and so special evenings, skiers carrying lighted torch-

es snake down the mountainsides into town. There are carolers and tree-lightings, along with New Year's Eve fireworks and street dancing.

At Vail, you can stay at Evergreen Lodge Dec. 21-26 for \$263 per night, 10% less than the 2000 rate. Keystone holiday rates start at \$100 per night and include free activities such as ice skating, wine tastings, and classes. Aspen has a 20% discount on condominiums Dec. 22-29. A one-bedroom junior suite (with a living room) at Aspen Meadows is \$195 per night, down from last year's \$365. Telluride is offering six nights of lodging and five days of skiing during Christmas

starting at \$777 per person—\$1,000 for a luxury condo. You'll do better, of course, if you can ski during off-peak weeks and book a package deal.

Travel

OFF THE SLOPES. Vail, developed in 1962 as an Austrian village in the Rockies, is still one of the West's most popular ski destinations. Last year, it opened the 645-acre Blue Sky Basin, with a "braided trail system" featuring islands of groomed runs. This year, it offers 30% off on groomed slopes—a concession, perhaps, to lure skiers who no longer want to ski powder. A trendy place to dine is The Larkspur, serving American and French country food. Dinner for two runs \$100 without drinks. Bully Fine serves Vail's signature drink, the Mudshoe-Kahlua, Bailey's Irish Cream, vodka, and an

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blended like a milk shake.

That's an upscale version of the Aspen Crud, a liquor-laced milk shake. It was a favorite of members of the World War II 10th Mountain Division of the U.S. Army, who trained nearby and helped turn Aspen into a ski resort after the war. You can still order the Crud at the Hotel Jerome bar.

Although Aspen attracts celebrities such as actors Kevin Costner and Jack Nicholson, it has deals for those on more modest budgets. The Get Into Aspen special, which includes roundtrip airfare from Chicago, five nights' lodging, and a four-day lift ticket for Aspen Highlands and Buttermilk, runs \$785 to \$853 per person, double occupancy. From Feb. 14, a package with four nights' lodging and three days' skiing starts at \$411. New deals are posted on Aspen's Web site about the 25th of each month.

ASPEN: The nightlife
ings at Telluride, a
ner mining town

While Aspen hasn't added major ski terrain year, several boutiques and restaurants have ned in the old silver-mining town. Try gador for Mediterranean food—dinner runs ut \$80 for two, without drinks—and NXT for tlife. Nonskiing activities include dog sled- g, paragliding, and taking in the health spas. eteran skiers say Telluride, a former gold- ing town in the San Juan Mountains, is like en a generation ago. Many like Telluride's -back atmosphere. Shopping is sparse com- ed with Vail and Aspen, but the nightlife gs here. Stop in at Fly Me to the Moon Sa- t, with live music ranging from funk to fusion rock and jazz, or the perennial favorite, the in the 1895 New Sheridan Hotel.

elluride offers January packages that include are, four nights' lodging, and three days' ski- —\$589 from Dallas, \$689 from Chicago, \$774 a Newark. The grand opening of the Prospect vl, with 733 acres of new ski terrain, is Jan. 13. There will be entertainment, street eing, après-ski parties, and fireworks. A spect Bowl package that includes three uts' lodging and two days' skiing starts 180 per person. Like most ski areas,

Telluride offers more than ski- ing. You can take snowmobile excursions into the back coun- try. Nighttime sleigh rides with dinner are \$75 per adult. **BRING THE KIDS.** Steamboat has always been a family area, and now the resort lets kids ski and stay for free when a parent books a mini- mum four nights' lodging, three-day lift ticket, and roundtrip airfare on Ameri- can, Continental, or North- west. The White Sale Snowsaver package, good from Jan. 5 to Feb. 13, in- cludes four nights in a motel plus a three-day lift ticket, and begins at \$310. Toys in the Attic, a restaurant with video games, is popular with families. You can find more sophisticated dining at Café Diva, at the base of the mountain, or take a chairlift and then a moonlit snowshoe tour to sup at Ragnar's, a Norwegian resta- rant at an elevation of 9,325 feet.

Another family area, Keystone is a planned community on Colorado's Snake River. It offers marshmallow roasts, storytelling evenings around the fire, and lectures on constellations. With Keystone's Family Adventure package, a family of four gets three nights in a two-bedroom con- dominium, lift tickets, a free lesson for each per- son, and some extras for \$1,000.

The deals are so good that some skiers are getting them without knowing it. Karen Lin- ton, a Lake Forest (Ill.) dental hygienist who's making her 23rd trip to Vail, booked a \$480- per-night loft at the Marriott's Mountain Re- sort in Vail for President's Day weekend. When Linton heard about all the ski bar- gains, she looked into them but kept her original reservation. "It's not a bad price after all," she says. It turned out she had gotten a good deal without having to ask for one. ■



ABOVE ASPEN: Those on a budget may get to ski with celebrities

KEYSTONE SKIERS: The resort hopes to attract families



TELLURIDE	VAIL
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lodging.com	vail.com

Toddlers In Paradise

Caribbean resorts that give spouses time alone, too

BY SUSAN
SCHERREIK

Like most parents of preschoolers, I am of two minds about vacations. I love to escape everyday pressures and savor simple pleasures like splashing in a kiddie pool with my children, Danny, 2, and Clare, 5. But I miss those times when my husband Ed and I can get away from it all, just the two of us.

Happily, when I sought a Caribbean vacation



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COMMENTS

Discovery Channel Camp for ages 4 and older includes Spanish galleon replica and water rides through an ersatz Mayan temple

Price is all-inclusive; features programs for children of all ages, water park, and 12-mile beach

All-inclusive; programs for kids ages 2 and older, including flying trapeze and in-line skating

Kids' camp for ages 3 and older, 13 tennis courts, horseback riding, Robert Trent Jones golf course

Data: Bayside Travel, Larchmont, N.Y.; resorts

last winter, I found a resort in Jamaica designed to help parents who want to be with their kids—but not all the time. The all-inclusive Franklyn D. Resort, an hour's drive from the Montego Bay airport, provides each visiting family with a "vacation nanny" for the length of their stay. The nanny, who is trained in first aid and CPR, spends as much or as little time with your children as you choose.

FDR and a sister resort, FDR Pebbles, also near Montego Bay, are unique in providing va-

cation nannies (888 FDR-KIDS; fdrholidays.com). But the Caribbean is filled with family resorts that vary widely in amenities as well as cost (table). FDR's formula works best for parents of babies and toddlers since most of the family resorts limit child care to camps for kids age 2 and older. Of course, parents at almost any resort can arrange for babysitting for an extra charge.

SPECIAL DEALS. Families with teens would be happier at larger, more exciting places such as Beaches Turks & Caicos Resort & Spa or the Atlantis in the Bahamas, which boast water parks. For those seeking the most upscale accommodations, Jamaica's Half Moon Golf, Tennis & Beach Club Resort, also near Montego Bay, offers a kids' camp for those 3 and older, 15 tennis courts, horseback riding, and a golf course designed by Robert Trent Jones.

While most Caribbean resorts haven't lowered their rates in response to the economy, as of September 11, many are offering an extra night free or other special promotions to attract business. FDR lets grandparents come along at no cost in January and early February, then gives the family a free upgrade to a two-bedroom at FDR's January rates through Changes, L'attitudes (www.changes.com), a discount travel agency that specializes in the Caribbean, start at \$242 daily per person for a six-night stay.

PEACE OF MIND: kids under 16 are free. A "vacation nanny" at work. Be aware that if you book directly through FDR and other family

resorts, you might pay more than if you go through a discount.

When we signed up last year at FDR, we were totally worried that the kids wouldn't be comfortable with a stranger. But Clare and Danny instantly took to our capable nanny, Sophia Donald, who in no time at all was tucking them in for naps and fetching them peanut-butter-and-jelly sandwiches. Sophia helped solve the problem of having one kid who wouldn't go to the water and one who wouldn't leave it. When she watched Danny in FDR's shady playground, Ed and I could play with Clare in the pool.

Nannies are on duty daily from 9 a.m. to 6 p.m., with an hour off for lunch. Like other guests, we hired ours to work in the evening, paying the resort's modest \$3 hourly rate. In any case, we could dine at our leisure in FDR's all-day-only restaurant, situated on a pier jutting into the sea. Meanwhile, Sophia took the kids to the children's dining area for hamburgers, hot dogs, and pasta. Later, Danny and Clare joined us at dessert and to listen to the reggae band that played most nights at the water's edge.

Evenings were my favorite time at FDR, listening to vintage Bob Marley tunes by moonlight while Clare and Danny joined other small children in the dance floor made me realize that there are moments when parents on vacation can truly relax and eat it, too.

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DONOR-ADVISED
FUNDS, 12 STEPS
TO SUCCESS
FOR WOMEN

BusinessWeek Investor

Getting Help With Your Giving

*Donor-advised funds add
convenience to charity*

BY NANETTE BYRNES

Two years ago, Bill and Connie Danko faced a looming tax bill from a mutual fund that no longer suited their portfolio, and which had ballooned with the bull market. So they decided to look into an idea Bill had seen in a newspaper ad: a donor-advised charitable fund on offer from mutual-fund giant Vanguard Group.

A donor-advised fund lets you give a gift of cash or an appreciated investment like stocks or mutual funds, take an immediate income tax deduction, and parcel out the money to your charities of choice. The more he looked into it, the more Danko liked it. The co-author of *The Millionaire Next Door* and chair of the marketing department at the State University of New York at Albany business school, Bill wanted to give to causes he believed in, but he also wanted to do so in an efficient way.

STRUCTURE. Another goal was to involve his three children, all in their early 20s, and get them in the habit of giving. He had looked into setting up a private foundation, but the paperwork seemed oppressive. He had always given directly to charity, but now he wanted something more structured, which would outlive him and Connie. The donor-advised fund was a way to do all that and get money to the hungry and homeless. Plus, "it's hassle-free," says Danko.

Danko is just one of thousands of charity-givers who have fueled a move into the philanthropic world by giant Wall Street investment houses. It began in 1992, when Fidelity Investments started a charity consisting of donor-advised funds that has grown into the second-largest charity in the U.S., according to the

Chronicle of Philanthropy, with more than \$1 billion in assets. In recent years, Charles Schwab, Vanguard, and other investment firms have followed suit. While 2001 figures aren't yet available, the funds continued to attract new money this year despite the recession and slump in the stock market. "These have been among the fastest-growing areas of giving," says Eileen Tempel, executive director of Indiana University Center on Philanthropy.

Still, such funds aren't for everyone. Mc-



re stiff minimum investments, typically \$10,000. In addition, if you know the charities you want to support, you're better off just giving money directly. That's because donor-advised funds charge administrative and management fees of around 1% to 2% of assets, which reduce the amount of your contribution. Another drawback: The Wall Street funds offer limited choice in choosing which charities need your money. "We don't give a lot of advice," says Kim Light-Violich, president of The Schwab Fund Charitable Giving.

ADVANTAGES. Nonetheless, the funds' advantages can be significant. Donor-advised funds take care of the paperwork. They also allow you to donate money now and get the tax break, then take as long as you want, even years, before deciding which charities to help. And a fund lets you donate anonymously if you choose to, thus avoiding subsequent dinnertime solicitations. The only restrictions: Donations must go to a philanthropy approved by the Internal Revenue Service, and the gift can't in any way benefit the donor.

The first donor-advised funds go back to the 1920s. They were an attempt to let people be active philanthropists during their lifetime, as opposed to leaving a sum to charity in their will. Until Fidelity came along, donor-advised funds had been largely the province of the nation's 400-odd local nonprofit community foundations. These groups, and national umbrella organizations such as the United Jewish Communities fund—the nation's No. 2 overseer of donor-advised funds—still account for 70% of the \$10 billion in assets held by major donor-advised funds, according to the *Chronicle of Philanthropy*.

The funds really took off when the Wall Street firms put their marketing muscle behind them. Initially, many in the philanthropic world were concerned about the ethics of for-profit firms running nonprofit charitable funds. In fact, Wall Street-backed funds aren't all that different from ones managed by foundations. Both charge an administrative fee to the donor, plus a management fee that goes to the money manager managing the balance in the donor's account. The Wall Street funds haven't charged more than nonprofit brethren.

Some have the Fidelity-type funds sat on their hands, as some had feared. Because fees are calculated as a percentage of the assets in the accounts, critics worried that managers would be tempted to hoard the money by discouraging donors from doling out the funds to charities. Federal law requires that only 5% of any nonprofit foundation's assets must be distributed in any given year. But this concern has faded. Indeed, the Wall Street funds typically distribute 18% to 30% of assets a year, vs. 5% or so by the average foundation fund, says Wright.

Wright says the Schwab Fund, which has been won over as well by the belief that the Wall Street funds have attracted new money, rather than simply diverting donations that would have

Giving Well

Donor-advised charitable funds hold your money and dole it out to the charities you choose when you tell them to do so. Here's what to consider about using a fund instead of giving directly to a charity:

DIRECT TO CHARITY

- ▶ All your money goes to the charity; you pay no fees.
- ▶ You must know now what charity you want to give to.

DONOR-ADVISED

- ▶ Your giving is reduced by administrative and money-management fees.
- ▶ You get the full tax break the year you set up the fund but wait until later years to decide which charities to give to.
- ▶ You must handle the paperwork on your gift. Giving cash is easy, but transferring stock is more complex.
- ▶ This is handled by the group running the fund and is covered by the administrative fee.
- ▶ You need a separate tax receipt for each gift you give.
- ▶ One statement from the fund at the time of the gift takes care of the IRS.

gone to charity anyway. By providing a service and taking away some of the hassles, the funds have stimulated people to give more than they otherwise would have, experts say.

In a recent study, Schwab found 57% of donors expected to give more to charities than they would have without the fund. Neil and Sandie Bernstein of Wayland, Mass., opened a donor-advised fund with Fidelity a few years ago to get the tax break on stock that had appreciated. They since have made contributions they may not otherwise have made. "It greases the wheels"

by making donations easier, says Sandie. The higher philanthropic profile also has helped to attract donors to funds run by community foundations, universities, and other nonprofits.

Even so, for someone who wants convenience but has little idea what charities to support, a donor-advised fund run by a community trust might be a better idea. Unlike the Wall Street ones, most have full-time staff to assess the community's needs and the effectiveness of different charities. Either way, for those who don't know what charity to support, a donor-advised fund buys you some time. That's no small thing for the many Americans who wait until the last weeks of December to do their giving. ■

Charities

Wall Street Goes Philanthropic

Here are the three largest donor-advised funds run by big investment managers

FUND	CONTACT INFORMATION	MINIMUM INVESTMENT	FEES (%)
FIDELITY INVESTMENTS CHARITABLE GIFT FUND	800 682-4438 www.charitablegift.org	\$10,000	0.70-1.76
VANGUARD CHARITABLE ENDOWMENT PROGRAM	888 383-4483 www.vanguardcharitable.org	25,000*	0.70**
SCHWAB FUND FOR CHARITABLE GIVING	800 746-6216 www.schwabcharitable.org	10,000	0.57-1.38

*Can give in \$5,000 increments over two years

**Fees are lower on gifts of \$5 million or more

Data: BusinessWeek

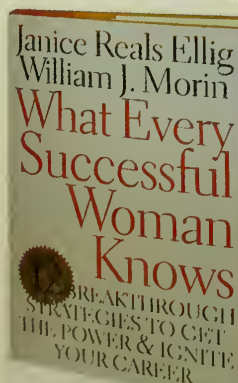
A 12-STEP PROGRAM TO GAINING POWER



BY TODDI GUTNER

hers@businessweek.com

Most management books for women are filled with platitudes. This one, by a male-female team of executive-development pros, offers much more



When the *Hers* column got started early last year, women's career-management books started crossing my desk—by the bundle. I didn't think much of the subject because I thought women could read the general management books. Still, after the 12th book arrived, I could no longer ignore the genre. It turns out that a how-to book for female managers makes sense. Since women hold only about 3% of senior positions in Corporate America, there are a limited number of role models to guide the next generation of female executives. Books that offer stories of successful businesswomen can make up for that deficit, teaching up-and-comers through the personal experience of those who blazed the trails.

Unfortunately, I found little of value in my recent review of about two dozen women's career-management books written in the past two years. Many were pedantic or platitudinous, filled with trite statements along the lines of this piece of advice from one author: "A key to effectiveness is to make responsible decisions on a timely basis with the information available and then to move forward."

Some books offer interesting profiles of high-powered businesswomen, such as eBay's Meg Whitman, but they don't put the stories into any useful context. While a chapter or two held my interest, I was challenged to find one worth a cover-to-cover read.

Then I picked up Janice Reals Ellig's and William J. Morin's *What Every Successful Woman Knows: 12 Breakthrough Strategies to Get the Power & Ignite Your Career* (\$21.95). Well-written and engaging, the book happens to be published by McGraw-Hill, which, like *BusinessWeek*, is owned by The McGraw-Hill Companies.

A big-picture focus sets this book apart from its competitors. Unlike the others, which string together a series of anecdotes that don't add up to a coherent plan of action, the book gives 12 well-defined, chronological strategies for getting ahead.

The male-female writing team is uniquely qualified to give advice. Ellig is a partner at executive-search firm Gould, McCoy & Chadick. Morin owns a management consulting firm that specializes in executive development.

Together, they argue that women are lagging from management positions into leadership roles in part because they don't have a strategic road map. "Women often try to manage too many details on their jobs and fail to focus on the big picture—their careers," write Ellig and Morin. "Women should follow the male model: Delegate more," they recommend.

One important strategy is for women to be politically savvy relationships. far too many corporate women today, political incompetence is leading to be a formidable stumbling block to the organizational power they seek," the authors write. Women need to find out who corporate power, provide to people with something they want, and then call on them for career help. "It requires a level of strategic thinking and tactical targeting that simply not been part of women's traditional skills conditioning they write.

WHO CAN HELP? A series of worksheets outline specific steps to take. For example, the authors provide a "Champions List" that identifies powerful people inside and outside the company who can help you. Then they provide spaces for you to write down who you can meet them and win over. I'm the first to moan when I see a worksheet, but it can get you into action.

On the negative side, I sometimes felt that if I did everything the book suggests, I would have no time for the rest of my life. The authors repeatedly encourage readers to use the Internet, attend classes, join organizations, and build a network to learn necessary skills. They also use many anonymous sources. Many of the other authors highlight who they met with, so the absence of names made me wonder who Ellig and Morin interviewed.

Still, this book got me thinking about my career and how to conduct myself at work—certainly a worthwhile subject for any woman professional.

An Action Plan for Your Career

- 1 Take stock of where you are and set goals for the future
- 2 Fit in and adapt before you initiate change
- 3 Make sure your job has profit-and-loss responsibility
- 4 Develop mutually useful relationships with your bosses
- 5 Create your own power base with people inside and outside the corporation
- 6 Speak your mind, but be relevant
- 7 Build your brand and toot your own horn—a lot
- 8 Spend time on significant projects
- 9 Devote 80% of your time to working your job, 20% to managing your career
- 10 Have technical, business, and people skills
- 11 Be wise about office romances and follow established procedures to address sexual harassment
- 12 Act with authority: Communicate a vision, take risks, and make things happen

Data: *What Every Successful Woman Knows: 12 Breakthrough Strategies to Get the Power & Ignite Your Career* by Janice Reals Ellig and William J. Morin

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BusinessWeek CFO Forum
Four Seasons Resort Aviara, Carlsbad, CA

June 20-21, 2002

The 2nd Annual
BusinessWeek CIO Summit
The Westin Copley Place, Boston, MA

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The 15th Annual
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The Ritz-Carlton, Washington, DC

December 5-6, 2002

The 7th Annual
**BusinessWeek Conference
on the Digital Economy**
The Fairmont Hotel, San Francisco, CA

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A COOL, CALM MARKET CALCULATOR



BY ROBERT BARKER
rb@businessweek.com

It's not an oracle, but the online oddsmaker called PAT can help you get a handle on hype from stock analysts

Will Cisco Systems' stock rebound to \$30? Are shares in General Electric set to reach a new high under its new CEO? Can Fidelity Magellan Fund recoup for investors what it lost them during 2001?

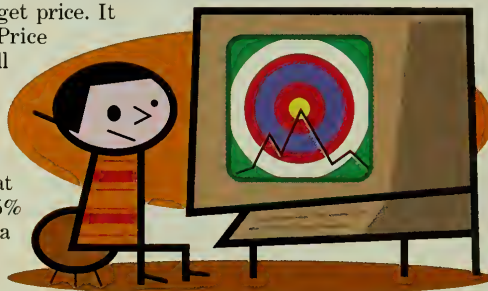
I wish I could offer conclusive answers to these questions and many others. No one can, but I will point you toward a free online tool that promises to help investors estimate the odds that a stock, mutual fund, option, and even a market index will reach a target price. It goes by the name PAT, for Price Acceptability Tester. You will find a link to it at a low-profile investor site called RiskGrades.com, where you can test PAT, as I did recently (www.riskgrades.com). Cisco at \$30? PAT says there's a 65% chance it will hit that within a year. A new high for GE? PAT gives it a 42% chance in the next 12 months. Fidelity Magellan making back its 2001 losses? A 71% chance by this time next year.

Can PAT be absolutely sure? Of course not, but PAT's operator, New York City-based RiskMetrics, suggests PAT offers a quick, statistically sound second opinion on almost any of the investment forecasts spewed out daily. "It's a reality check for anybody who hears a price target," Michael Thompson, RiskMetrics' market strategist, told me. A 1998 spin-off of J.P. Morgan, RiskMetrics mostly serves institutional investors. It sells them software and data they use to get a handle on the risk in such Frankensteins of Wall Street as collateralized

debt obligations. RiskMetrics also hopes to use as clients financial advisers to individual investors. PAT is one of a host of software tools that offer them.

PAT works first by determining how risky a stock has been, measured by the volatility of its price swings over the past 152 trading days. Next, it considers the past seven years' average annual stock market returns for the stock's industry group. PAT assigned Cisco, for example, a risk rating about three times as high as the average security and an expected annual return of 12.1%. Disagree with either or both of the assumptions? PAT lets you adjust them upward or downward. It then goes on to reckon the odds that a stock will hit a given target price over the next 3, 6, or 12 months.

RiskMetrics prominently warns users against relying on PAT's conclusions without also using fundamental research into a company's prospects—no mention of common sense. A good thing, because some extreme



circumstances PAT renders nonsense: When I checked the probability of Enron zooming from its current price of \$1 a share past its peak of over \$90, PAT suggested a 46% likelihood in the next year. It justifies those odds based on Enron's huge recent volatility and the assumption that what can swing down also can swing up. In this case, I don't think **STRIKE PRICE.** All the same, PAT could be useful to many individuals in at least two ways. First, it offers an independent check on target prices set by Street analysts and gurus. How likely is it, say, that the Standard & Poor's 500-stock index will hit a new high in the next year? Based on its conclusion on the index' historic volatility and returns, PAT says the odds are no higher than 30%. PAT could obviously prove wrong, but because the past can't predict the future. But the burden is on whoever sets an improbable target to suggest how the odds may be upset.

Second, anyone with employee stock options must guess how far beyond the options' strike price their company's stock may go. If you have options with a strike price of \$40 a share, and your company's stock is now \$50, for example, you need to estimate the likelihood that the stock will climb to, say, \$60 or \$70. While you know more about your company's profit outlook than does PAT, it can bloodlessly assess prospects for the shares in the stock market. Putting your company's stock together this way should boost the odds of finding better answers to some tough ques-

Chances Are . . .

RiskMetrics' new online tool, the Price Acceptability Tester, aims to give investors a reality check when they consider target prices for stocks, market indexes, and even mutual funds.

Here's what I saw when I tested it on Dec. 6:

STOCK OR FUND (Symbol)	RECENT PRICE	TARGET PRICE	PROBABILITY OF HITTING TARGET IN NEXT		
			3 MONTHS	6 MONTHS	12 MONTHS
AOL TIME WARNER (AOL)	\$35.83	\$50.00	23%	43%	62%
AT&T (T)	17.57	25.00	6	21	41
CISCO SYSTEMS (CSCO)	21.54	30.00	32	50	65
FIDELITY MAGELLAN (FMAGX)	106.13	118.36	33	53	71
GENERAL ELECTRIC (GE)	37.55	60.51	3	16	42
KRISPY KREME (KKD)	38.23	50.00	27	45	62
METLIFE (MET)	27.98	35.00	16	40	65
MICROSOFT (MSFT)	68.10	80.00	53	72	86
STANDARD & POOR'S 500 (SPX)	1168.77	1527.46	1	9	30

Data: RiskMetrics Group, BusinessWeek

BusinessWeek online

For barker.online, go to
www.businessweek.com/investor/ and click on "Cool"

IMPAX: A TEVA TARGET?



GENE G. MARCIAL

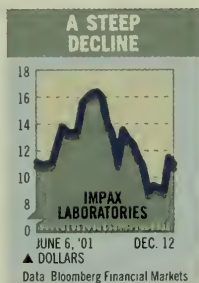
el's Teva may
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erics partner.
Countrywide Credit
be talking to
s suitors.
Key Energy is
or a rebound
e oil patch

Takeovers are rampant in the medical and biotech world: This year has seen 200 deals worth more than \$7 billion—capped by Millennium Pharmaceuticals' recent move to buy Cor Therapeutics for \$2 billion (page 40). This column spotted Cor as buyout bait (BW—Oct. 29). Who's next?

One target may be Impax Laboratories (IPXL), which makes specialty prescription drugs using advanced formulation and drug-delivery technologies. The likely buyer: Israel's Teva Pharmaceutical Industries, one of the world's top makers of generics. In June, Impax and Teva signed a strategic partnership giving Teva 10-year rights to market 12 Impax products, including 5 of Impax' 13 accelerated new drug applications awaiting Food & Drug Administration approval. In exchange, Teva agreed to buy \$15 million worth of Impax stock, now trading at 11: \$3.75 million per quarter from September, 2001, through June, 2002.

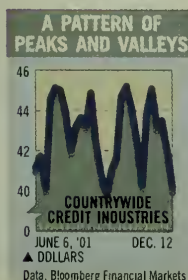
Teva paid 15.73 a share for the first batch. The stock deal comes on top of \$22 million in milestone payments to Impax—plus sharing of development and marketing costs.

"Impax is a perfect fit for Teva, which lacks the technologies [Impax has]," says analyst Adam Greene of Dresdner Kleinwort Wasserstein, who rates Impax a strong buy. His price target is 18, but in a buyout, he thinks it is worth much more. Impax CEO Barry Edwards says Teva hasn't brought up the subject. Impax' full pipeline is one big reason behind Teva's pact. Impax develops products by reengineering drugs already on the market—including a generic version of Prilosec, expected to be launched in late 2002. It also uses its drug-delivery technologies to improve existing medicines. Greene sees Impax making money by 2003, earning 67¢ a share—after the launch of 10 generic drugs. Teva did not return calls.



BUYOUT BUZZ AT COUNTRYWIDE

Shares of Countrywide Credit Industries (CCR), the nation's largest independent mortgage company, have been on the ropes—down from 50 in January to 40 lately. A perception that mortgage rates have bottomed out and that the refinancing boom may be over has hurt the stock, now trading 30% to 35% below its traditional valuation, says Richard Eckert of Sutro, who rates the stock a buy, with a 12-month price target of 55. Investors could be



"overreacting to the recent rise in mortgage rates and the decline in refinance applications," he says. Eckert believes that rates are still low by historical standards and that the "refi index is still in boom [territory]"—and likely to stay that way through the end of 2002's first quarter.

Countrywide is "priced well below its private market value of about 75 a share," says analyst Mike McMahon of investment firm Sandler O'Neill & Partners, who rates the stock a buy.

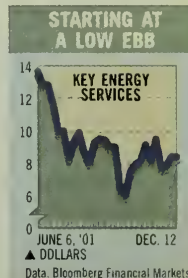
The rumor is that suitors have been talking to Countrywide for a merger or buyout. Four banks—three American and one British—have been in separate talks with Countrywide, say some pros.

McMahon says Countrywide is a plum prize and "may consider a strategic alliance." He thinks it will favor a European bank that requires access to the U.S. market. Last year, Countrywide had agreed to be acquired by a British bank, says McMahon, but it fell through just before it was announced. He says one West Coast bank was also interested. But McMahon says he doesn't know if either one has come back to the table, or if there are new suitors. He expects Countrywide to earn \$4.81 a share in calendar 2002 and \$5.27 in 2003. McMahon's estimates reflect improved earnings from its mortgage servicing business. The company has cut costs, he adds, and boosted earnings from insurance, banking, and capital-markets operations. Countrywide didn't respond to calls.

GETTING UP STEAM AT KEY ENERGY

Energy stocks have been on the skids because of the drop in oil and gas prices. But this may be the time to start cherry-picking in the group, says James Crandell, veteran oil-services analyst at Lehman Brothers, whose top choice is Big Board-listed Key Energy Services (KEG).

The stock has lost lots of ground: It's down from 15 in mid-May to 8. Key Energy, one of the world's largest rig-based servicing companies, has strengthened its balance sheet by slashing debt from 70% of capitalization to 45%. And with its diversified operations—including well servicing, contract drilling, and other oil-field services—Key is well-positioned to benefit from the next upturn in oil drilling, says Crandell. He sees such a recovery in mid-2002, when oil and gas prices should rally as the recession eases. He expects Key to earn 80¢ a share in fiscal 2002, ending June 30, and 90¢ in fiscal 2003.



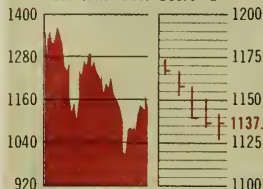
BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks

S&P 500

Dec. June Dec. Dec. 6-12



COMMENTARY

The markets ended on a low note on Dec. 12, hit by grim profit outlooks from two of the 30 Dow industrial stocks, Merck and American Express. Enron's blowup dragged down shares of power producers, too. The S&P 500 fell 2.8% on the week and the Dow fell 2.2%, despite the Fed's interest rate cut, the 11th so far this year. The Nasdaq fell 1.7%.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Dec. 12	Week	% change Year to date	Last 12 months
S&P 500	1137.1	-2.8	-13.9	-17.1
Dow Jones Industrials	9894.8	-2.2	-8.3	-8.1
Nasdaq Composite	2011.4	-1.7	-18.6	-31.4
S&P MidCap 400	495.3	-1.7	-4.2	-4.3
S&P SmallCap 600	223.6	-1.5	1.8	4.6
Wilshire 5000	10,566.1	-2.5	-13.2	-16.7

SECTORS

	Dec. 12	Week	% change Year to date	Last 12 months
BusinessWeek 50*	723.6	-4.1	-25.4	-32.8
BusinessWeek Info Tech 100**	433.5	-1.5	-23.4	-39.8
S&P/BARRA Growth	591.7	-2.8	-13.9	-21.9
S&P/BARRA Value	544.8	-2.9	-14.4	-12.9
S&P Energy	775.8	-4.6	-16.7	-12.9
S&P Financials	145.0	-1.1	-12.0	-9.7
S&P REIT	92.9	-0.5	5.7	7.9
S&P Transportation	675.7	-2.7	-3.1	-3.8
S&P Utilities	222.8	-4.8	-36.5	-32.1
GSTI Internet	109.6	2.7	-39.7	-57.0
PSE Technology	709.4	-2.1	-12.9	-22.0

*Mar. 19, 1999 = 1000 **Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Airlines	22.8	72.6
Homebuilding	21.6	52.2
Instrumentation	21.4	40.4
Photography/Imaging	18.5	38.7
Commercial Services	17.9	37.2

EQUITY FUND CATEGORIES

4-week total return	%	52-week total return	%
Leaders		Leaders	
Pacific/Asia ex-Japan	12.9	Precious Metals	16.6
Diversified Emerging Mkts.	8.3	Small-cap Value	15.1
Latin America	7.4	Real Estate	11.7
Technology	6.5	Mid-cap Value	8.8
Laggards		Laggards	
Utilities	-5.7	Technology	-43.8
Natural Resources	-4.4	Communications	-42.6
Domestic Hybrid	-0.3	Japan	-35.2
Japan	-0.2	Large-cap Growth	-26.9

EQUITY FUNDS

4-week total return	%	52-week total return	%
Leaders		Leaders	
iShares MSCI Taiwan Idx.	27.2	Schroder Capital Ultra Inv.	79.8
Van Eck Asia Dynasty A	18.9	CGM Focus	77.9
Investec Asia New Economy	17.6	Pilgrim Russia A	51.8
iShares MSCI Singapore Idx.	17.3	Bost. Part. Sm. Cap Val. II	48.5
Laggards		Laggards	
D Higgins	-14.6	ProFunds UltraDTC Inv.	-77.6
Galaxy II Utility Index	-13.3	Berkshire Focus	-76.2
Rydex Dynamic Vent. 100	-12.4	Berkshire Technology	-75.7
ProFunds UltraShort DTC	-12.1	Merrill Lynch Focus 20 B	-75.5

Data: Standard & Poor's

THE WEEK AHEAD

NEW RESIDENTIAL CONSTRUCTION Tuesday, Dec. 18, 8:30 a.m. EST ► Housing starts during November are forecast to have slipped to an annual rate of 1.54 million, after a pace of 1.55 million homes in October. That's based on the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies.

INTERNATIONAL TRADE Wednesday, Dec. 19, 8:30 a.m. EST ► The trade deficit in October likely widened to \$28 billion as im-

ports are expected to rebound more strongly than exports. In September, the trade deficit narrowed to a smaller-than-expected \$18.7 billion, due to border closings and interruptions resulting from the September 11 terrorist attacks.

LEADING INDICATORS Wednesday, Dec. 19, 10 a.m. EST ► The Conference Board's November composite index of leading economic indicators likely inched up 0.1%, according to S&P's MMS. In October, the index climbed 0.3%.

FEDERAL BUDGET Thursday, Dec. 21, 10 a.m. EST ► The U.S. Treasury probably a \$45 billion deficit for November from \$23.6 billion in November. The poor economy and increasing interest rates are expected to whittle the 2002 budget surplus to just \$3 billion.

PERSONAL INCOME Friday, Dec. 22, 8:30 a.m. EDT ► Personal income in November probably grew 0.2%. Consumer spending likely fell 0.5% in November, after an unexpected jump of 2.9% in October.

GLOBAL MARKETS

	Dec. 12	Week	% change Year to date	Last 12 months
S&P Euro Plus (U.S. Dollar)	1066.8	-1.9	-13.9	-17.1
London (FT-SE 100)	5120.0	-4.0	-8.3	-8.1
Paris (CAC 40)	4510.7	-3.6	-18.6	-31.4
Frankfurt (DAX)	5062.6	-3.8	-4.2	-4.3
Tokyo (NIKKEI 225)	10,801.5	0.8	1.8	4.6
Hong Kong (Hang Seng)	11,847.1	1.4	-13.2	-16.7
Toronto (TSE 300)	7577.7	-0.6		
Mexico City (IPC)	6150.3	3.7		

FUNDAMENTALS

	Dec. 11	Week
S&P 500 Dividend Yield	1.37%	1.37%
S&P 500 P/E Ratio (Trailing 12 mos.)	45.8	46.1
S&P 500 P/E Ratio (Next 12 mos.)*	21.7	21.7
First Call Earnings Revision*	-2.24%	-1.3%

*First Call Corp.

TECHNICAL INDICATORS

	Dec. 11	Week
S&P 500 200-day average	1173.6	1177.7
Stocks above 200-day average	50.0%	51.1%
Options: Put/call ratio	0.71	0.71
Insiders: Vickers Sell/buy ratio	1.29	1.29

WORST-PERFORMING GROUPS

	Last month %	Last 12 months %	
Natural Gas	-24.3	Communications	-43.8
Engineering & Constr.	-11.5	Natural Gas	-42.6
Food Chains	-9.6	Instrumentation	-35.2
Oil-Well Equip. & Svcs.	-7.4	Oil-Well Equip. & Svcs.	-26.9
Personal Loans	-7.1	Computer Systems	

Interest Rates

KEY RATES

	Dec. 12	Week
MONEY MARKET FUNDS	2.01%	2.11%
90-DAY TREASURY BILLS	1.67	1.76
2-YEAR TREASURY NOTES	2.94	3.06
10-YEAR TREASURY NOTES	4.98	4.89
30-YEAR TREASURY BONDS	5.46	5.36
30-YEAR FIXED MORTGAGE†	7.07	6.88

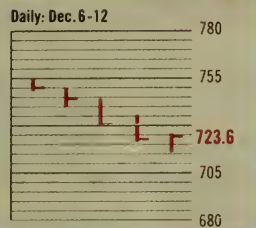
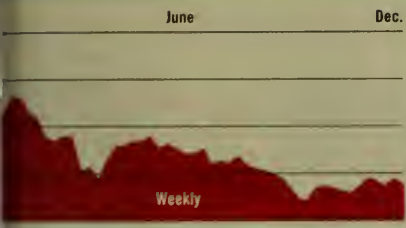
†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.37%
TAXABLE EQUIVALENT	6.33
INSURED REVENUE BONDS	4.59
TAXABLE EQUIVALENT	6.65

The BUSINESSWEEK 50

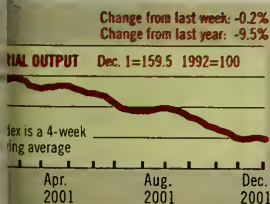


not clobbered this week, down 4.1%. Shares of AES sank 15.3% after Moody's downgraded some junk. Merck fell 11.7% and Calpine fell 21.1% in a backlash to Enron's saga. Some financial modestly, including Washington Mutual, up 1.8%. Forest Labs jumped 8.9% after an analyst up-ber optic player ADC Telecommunications rose 5.8% after inking a deal with BellSouth Corp.

COMPANY PERFORMANCE

Company	% change		Rank	Company	% change	
	Week	Since 3/1/01			Week	Since 3/1/01
International	-6.4	2.5	26	Verizon Communications	-1.6	-2.2
Petroleum	-6.1	-18.3	27	Citigroup	-1.7	-1.0
	-21.1	-64.3	28	Sun Microsystems	-7.4	-32.8
	-13.4	-46.5	29	Merck	-11.7	-26.6
Materials	-2.3	-1.0	30	El Paso	-7.2	-42.2
Financial	-4.7	-94.2	31	Altera	-8.0	-2.1
Petroleum	-7.5	3.6	32	Marsh & McLennan	-5.5	-1.9
	-4.5	-21.2	33	Household International	-11.2	-7.3
Ge	-7.7	-22.2	34	ChevronTexaco	-2.2	-1.4
	-1.8	-29.4	35	SBC Communications	-0.3	-16.0
Brothers Holdings	-1.9	-2.0	36	Mercury Interactive	-0.7	-39.8
	-9.2	-62.0	37	AOL Time Warner	-9.3	-26.1
	-15.3	-73.7	38	Washington Mutual	1.8	-6.5
Laboratories	8.9	14.3	39	General Dynamics	-2.3	19.2
Financial	-1.3	-9.5	40	Comcast	0.0	-7.5
Technology	-4.0	-11.6	41	Morgan Stanley Dean Witter	-1.5	-13.5
	-0.4	1.8	42	Tellabs	-3.2	-62.8
Hess	-3.7	-19.9	43	Exxon Mobil	-3.8	-8.1
Energy	-7.3	-16.6	44	Scientific-Atlanta	-7.6	-38.7
Communications	5.8	-52.5	45	U.S. Bancorp	1.6	-15.3
Financial	-3.5	-11.2	46	Paychex	-0.9	-1.1
Petroleum	-4.1	5.2	47	Merrill Lynch	0.6	-12.0
Devices	-2.9	11.4	48	Bed Bath & Beyond	-8.2	26.5
Sources	-8.8	-18.3	49	Texas Instruments	-3.9	-0.6
Health	-3.8	-2.6	50	Teradyne	-2.8	0.6

Production Index



Production index resumed its slide during the late calculation of the four-week moving average fell to 158.2, from 158.8. On a seasonally adjusted basis, autos and truck assemblies posted drops, with steel and crude-oil refining and rail-freight traffic rose on strong rebounds in vehicle, and chemicals shipments. Lumber production also rose, while electric power unchanged during the week.

Each of the index components is at www.businessweek.com.
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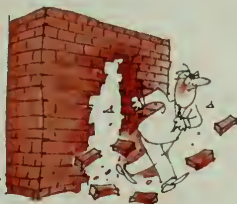
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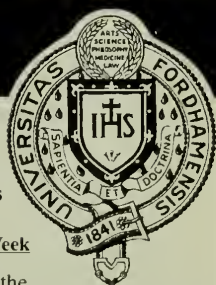
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RETHINK THE STIMULUS PACKAGE

There's good news and bad news on the interest-rate front. Thanks to quick action by the Federal Reserve, short-term rates have dropped a dramatic 425 basis points since March, 2000, buoying the housing and auto markets through the downturn and setting the stage for recovery. Long-term rates, however, have recently reversed course and backed up sharply, threatening that rally. Anyone shopping for mortgages in the past few weeks knows that rates are up to 7% again. Not good.

There are a number of reasons for this long-term rate hiccup. At the end of the recessions of 1975, '83, and '91, long-term rates also increased, albeit temporarily, as inflation worries returned to grip investors. This may be occurring right now as the economy bottoms out. But something else may be at work, too: the shift of the federal budget from surplus to deficit until at least 2005. The financial markets have been expecting surpluses as far as the eye could see to pay for backloaded tax cuts over the next decade. With unexpected military and home-defense spending beginning to soar, worries over deficit spending and rising inflation in the years ahead are resurfacing, pushing up long-term rates. It's fine for the budget to run red

when the economy is in recession. That puts more money into consumers' hands and pumps up demand. But the economy should be on the mend by late 2002, if not earlier. Deficits that extend any longer will hurt, not help, growth.

It may be wise to take a moment to regain control of fiscal policy in Washington. That means tempering the stimulus package now being debated in Congress—or perhaps postponing it entirely. Congress has already taken far too long in passing it for it to have any real economic impact on recovery. Moreover, the package itself is a hodgepodge of barrel spending and tax cut proposals designed more to cater to political constituencies than to address the needs of the overall economy.

If the politicians insist on passing a bill before the Christmas holiday, they should trim it down to three items: cutting depreciation rates for just one year, to encourage companies to buy new equipment; extending unemployment benefits for a few more weeks; and accelerating a marginal tax rate cut for just one bracket, lowering the 27% bracket to 25%. Everything else should be stripped out. It's time to get about getting the budget back into balance.

LET AUDITORS BE AUDITORS

Sunbeam, Waste Management, and now Enron. Auditor Andersen has certainly had a bad run. It has vouched for company books that have turned out to be pages of false and misleading statements, leaving investors dumbfounded and poorer. Andersen paid \$110 to settle Sunbeam Corp. shareholder litigation and \$7 million in fines for Waste Management Inc.—plus part of a \$220 million class action. Investors have lost nearly \$80 billion on Enron's collapse, and Andersen is facing new class actions over its mishandling of the financial statements of the once-mighty energy trader (page 30).

When is this going to end? America's equity culture requires honesty and transparency from its companies so that investors can calculate risk. People need to know how to properly value companies, and they can't if income is overstated and assets and debt are hidden in secret partnerships, which appears to be the case with Enron Corp.

Securities & Exchange Commission Chairman Harvey L. Pitt is launching a formal investigation into Enron's collapse. He has several worthy proposals to reinforce the self-regulation of the auditing function. But Pitt is naive to think that modest changes will solve the problem. Andersen made more money selling consulting services to Enron last year than auditing its books. In many firms, auditors are compensated for the service business they bring in. Until this conflict of interest is ended, there will always be the temptation to go easy on the company that provides service fees. Independence of the auditing function is critical.

Pitt is right to emphasize preventive maintenance, encouraging companies and their auditors to consult the SEC early to clear up confusing gray-area accounting issues. The antagonism between the SEC under Chairman Arthur Levitt and the auditing profession was so palpable that there was little communication between the two.

Pitt is also correct in trying to strengthen the role of audit committees on the boards of directors. He wants to make it a duty for them to sit down with management and the auditors and single out the four or five key accounting principles that have the greatest impact on their company's financial position. They should clarify and define the complex and ambiguous standards and get the company to adhere by them. The audit committees should also make standards available to investors.

But neither proposal goes far enough. GAAP, the generally accepted accounting principles, desperately need to be revised to deal with cash flow and other issues relevant in a fast-changing, high-tech economy. The whole move to off-balance-sheet accounting should be reassessed. Opaque partnerships that hide assets and debt do not serve the interests of investors. Heavy shareholder pressure from the Enron fallout, however, has helped. Enron Corp. just moved \$2 billion in partnership debt onto its balance sheet. Finally, Pitt should consider requiring companies to change their auditors every three or four years. Companies usually tend to retain auditors who go easy on them, as we have seen time and again.



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BusinessWeek

31, 2001 / JANUARY 7, 2002

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Where To Invest 2002

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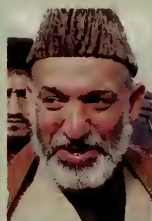
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Managers risk morale problems in their quest to cut costs page 42



MR. FIERCE G
Why Wolfowitz is biggest hawk on Bush's team page



A TALL ORDER
What it will take to rebuild battered Afghanistan page 56



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Wildstrom foresees a rise in home networking and broadband use page 30



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Where To Invest



DUCTION

PROSPERING AMID PERIL

After the beating the market took in 2001, *BusinessWeek's* Investor Outlook forecast for 2002 is optimistic—but cautiously so

FRAMEWORK

SOBER RECOVERY

The recession will be mild, but growth will be slow as the economy picks up next year, economists say

ESSIMISTIC PROGNOSTICATOR

James Paulsen tops *BusinessWeek's* survey on the outlook for 2001

WASHINGTON OUTLOOK

After a year of tax cuts and bailouts, Bush & Co. must get stingy

LOOKING AT THE TEA LEAVES

These are the six signs that point to an economic recovery

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There are winners just waiting to be picked—and our Investment Outlook Scoreboard is your guide

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BW's Nanette Byrnes on how to take care of all your donations with a single check



■ THE LOW POINT?:

The economy may have seen the worst, but a rebound will be slow, says BW's Jim Cooper



TOOLS

■ YOUR PORTFOLIO:

Check on the health of your investments



■ STOCK SCREENER:

Use more than 70 criteria to pan for gold among the equities



■ **MBA SEARCH:** Which is the right business school for you and your needs?



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The Game Boom

Why are Microsoft and Nintendo going all out to challenge Sony in the video-game wars? Because the market is now even bigger than Hollywood's box-office take



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Commentary: Once-confident prognosticators find that discerning tomorrow's world has become much harder



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Street Wise: Clothing giant Gap's stock is in the cellar, as shoppers look elsewhere for casuals. Still, a revival may be in the offing

SMALL BUSINESS A resource for entrepreneurs

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Venture Capital: What do women want? For starters, greater access to venture capital



TECHNOLOGY State-of-the-art coverage of info tech

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Privacy Matters: Microsoft's IE 6 browser forces Web sites to reveal information they collect



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B-School Q&A: Sally Jaeger, director of MBA admissions at Dartmouth College, discusses the process

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Sound Money: If poor nations are denied the chance to sell their goods in the West, expect them to export terror and hatred instead

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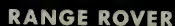
Ask Careers: How do you deal with interview questions that probe—however indirectly—how old you are? Very carefully



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A black and white photograph of a woman in a long coat standing next to a vintage car. The car is a dark-colored sedan with a light-colored top, possibly a convertible or a car with a removable top. The woman is standing to the left of the car, looking towards the camera. The background is slightly blurred, showing what appears to be a building or a street scene.





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Up Front

EDITED BY SHERIDAN PRASAD

SLUGFESTS

CSFB'S NOT-SO-PAINFUL SETTLEMENT

WALL STREET INVESTMENT banks are grappling with hundreds of class actions brought by disgruntled investors alleging everything from market manipulation to kickbacks from their initial public offerings. So is the \$100 million that Credit Suisse First Boston is reportedly close to paying to settle federal charges that it mishandled IPOs really that steep?

■It's a mere 22% of the \$451 million in fees CSFB earned by underwriting tech companies in 2000, according to Thomson Financial.

■It's roughly how much CSFB's tech-banking superstar Frank Quattrone earned every year in the late 1990s, according to those familiar with his salary and bonuses.

■It's one-quarter as much as a settlement by just one

QUATTRONE: family, the \$100 million Pritzkers, who man? must pay \$460 million

to U.S. regulators to resolve claims in the July failure of Superior Bank FSB, which they half-owned.

Wall Street veterans say this shows the system is out of whack. "I am dismayed," says John Gutfreund, former Salomon Brothers CEO, dubbed the King of Wall Street by *BusinessWeek* in 1985, who resigned in 1991 following a Treasury-auction bidding scandal. "In their mind, it's probably a slap on the wrist." CSFB declined to comment. *Emily Thornton*

MOTOR CITY

FORD'S WRONG TURN ON THE INTERNET

THE LEGACY OF FORMER CEO Jacques Nasser is still causing pain at Ford Motor. The company recently admitted it lost almost its entire \$50 million investment in a venture firm, Internet Capital Group, which provides seed money for business-to-business e-commerce. Ford invested in December, 1999, when ICG shares were at

NASSER: A legacy of Web woes

\$108—and back when investing in such things seemed like a good idea. Now it's dumping them for around \$1.15 a share.

And that's not the only Internet idea backed by Nasser that hasn't panned out. Already, Ford has taken a \$199 million charge to write down several investments in e-commerce and other ventures. Nasser had hoped to recast Ford as a cutting-edge e-commerce giant, but the core automotive business suffered, costing him his job.

Not surprisingly, new CEO William Clay Ford Jr. is preaching back-to-basics. While still embracing the Net as a way to become more efficient, he won't be investing in startups any time soon. *Joann Muller*

TALK SHOW "I've had an entertainment heart since I was about 20."

—Barry Diller, chairman of USA Networks, announcing that Vivendi will buy the entertainment assets of his company

NETIZENS

THE BLOOM IS OFF IDEALAB

OH, HOW THE MIGHTY HAVE fallen. Back in the heyday of the tech boom, Bill Gross, the 43-year-old entrepreneur who popularized Internet incubators, could do no wrong. He sold \$1 billion worth of preferred stock to wealthy individuals and businesses such as Dell Computer and T. Rowe Price. He even brought in a blue-chip director, General Electric ex-Chair Jack Welch.

Now, his brainchild, Idealab, is in such a slump that those investors are hopping mad. They say Gross wasted \$800 million of their money buying controlling stakes in duds, such as cosmetics e-tailer Eve.com. They claim Gross has ignored their pleas to liquidate Idealab and is instead offering to buy

them out at a pittance—on the dollar, instead of 35¢ they want. Says investor Guy Oseary, co-owner of singer Madonna's Maverick Records: "If he'd just liquidated, he'd make a lot of people happier."

Gross wouldn't comment. But Idealab President Mark Goodstein says the company is trying to balance the interests of some investors who want out and others who want to stay.

"The market took a terrible turn, and they are angry," she says. "They share their frustration, and now work hard to secure return for all shareholders."

The angry investors had hoped Welch would buy them. But he resigned from most of his board positions in September. "I never made a nickel on Idealab," says Welch. And the unhappy investors: "Tell them to get good advisers." *Christopher Palmieri and Linda Himelstein*

THE LIST THE BIGGER THEY ARE ...

Thirteen companies, all tech, fell out of the Nasdaq 100 index when it did its annual reranking, in favor of biotechs (page 52). Here are the biggest names:*

COMPANY	SHARE PRICE AS OF 12/14	DROP FROM SHARE PRICE'S HIGH
ARIBA	\$5.92	96% (Sept. 22, 2000)
BROADVISION	2.88	97% (Mar. 3, 2000)
CMGI	1.97	99% (Dec. 31, 1999)
CNET	7.02	91% (Dec. 17, 1999)
NOVELL	4.48	89% (Dec. 31, 1999)
PALM	3.47	96% (Mar. 3, 2000)
REAL NETWORKS	6.22	93% (Dec. 10, 1999)
3COM	4.82	76% (Oct. 6, 2000)

*The others: Inktomi, Level 3 Communications, McLeod USA, Metromedia, and Parametric Technology
Data: Nasdaq, Bloomberg Financial Markets

CLOCKWISE FROM TOP LEFT: PHOTOGRAPH BY JAY BLAKESBERG; PHOTOGRAPH BY ALAN LEVENSON.COM WITH PHOTO ILLUSTRATION BY JOE CALVIELLO.BW; CHART GRAPHIC BY STEPHEN KENNEDY/BI; PHOTOGRAPH BY KENNETH LAMBERT/PA/NOISE WORLD



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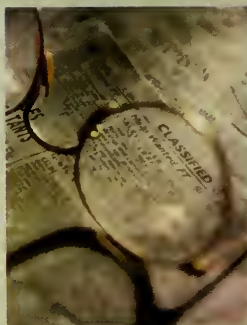
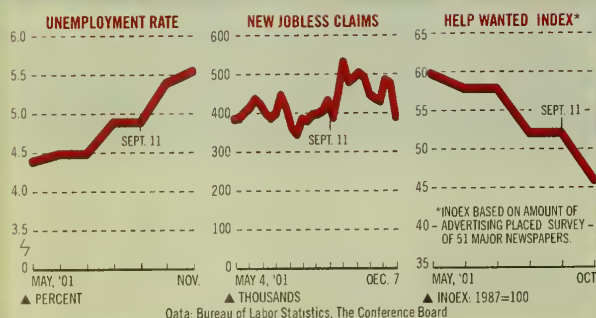
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SEPTEMBER 11: A BLOW TO A WEAKENING ECONOMY

The attacks slammed an economy that was already hurting. While some sectors are slowly getting back to normal, others are still depressed and may feel the impact for a long time. Here's a look at the fallout:

THE JOB MARKET



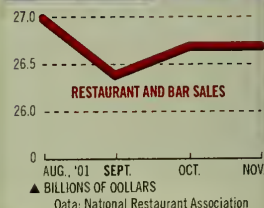
AIR TRAVEL

DAILY U.S. FLIGHTS AS OF
SEPTEMBER 10: **18,727**

AS OF
DECEMBER: **15,103**

Data: Federal Aviation Administration

DINING OUT



REAL ESTATE

NEW YORK CITY
COMMERCIAL VACANCY RATE,
PRE-SEPTEMBER 11: **8.0%**

DECEMBER
VACANCY RATE: **9.3%**

Data: Grubb & Ellis

BORDER CROSSINGS



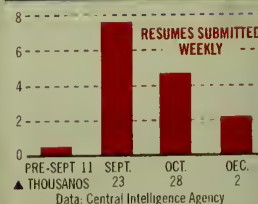
U. S. borders went to Alert Level 1, slowing traffic into the U. S., but never closed. Wait times have since diminished.*

BORDER CROSSING	MID-SEPTEMBER	MID-OCTOBER	LATE NOVEMBER
BLAINE, WASH./VANCOUVER	90 minutes	20 minutes	No delay
BUFFALO/NIAGARA FALLS, ONT.	30 minutes	No delay	5 minutes
DETROIT/WINDSOR, ONT.	150 minutes	15 minutes	2 minutes
EL PASO/JUAREZ	180 minutes	70 minutes	62 minutes
SAN YSIDRO, CALIF./TIJUANA	180 minutes	68 minutes	45 minutes

*Passenger vehicle traffic

Data: U.S. Customs Service

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IS IT REAL?



MYTH: Bigfoot in the woods.



FACT: Linux in the enterprise.

The myths and facts about Linux in the enterprise.

MYTH: Linux® isn't ready for the enterprise.

FACT: Not only is Linux ready for the enterprise, it's already there, in companies of all different sizes. Consider this: according to IDC, one in four new server OS shipments in 2000 was a Linux shipment. And Linux continues to grow faster than any other server operating system.

Example: Korean Airlines consolidated flight scheduling systems and daily revenue tracking from a variety of different platforms onto Linux servers. Supporting service to 77 cities in 29 countries, more than 3,000 Korean Air pilots, flight attendants and other employees use the systems daily.

Example: Telia, Scandinavia's largest telecommunications and Internet service provider, recently replaced 70 UNIX® servers with one IBM mainframe enabled to run 1,500 copies of Linux simultaneously.

Example: Grede Foundries is a \$600 million supplier of industrial castings. Grede moved DNS, mail and Web serving, network monitoring applications and online manuals to Linux on their mainframe, gaining performance and reliability and cutting costs.

MYTH: Linux lacks business applications.

FACT: Over 2,500 Linux applications are listed in the IBM Global Solutions Directory at ibm.com. Included are over 1,300 e-business applications.

Key developers have embraced Linux and more are doing so all the time. Including names like SAP, SAS®, jBASE, QAD and Sanchez™. They realize that Linux is a key to flexible infrastructure. IBM itself is the world's leading middleware company, and all our key middleware is Linux-ready.

MYTH: Linux lacks service and support.

FACT: At IBM and IBM Global Services (the world's largest technology services and consulting company), we're backing Linux with the same level of service we offer on any other operating system. Same as UNIX. Same as Windows®. Same as IBM's operating systems.

IBM has hundreds of professionals dedicated to Linux, ready to design, build and support enterprise-level e-business infrastructures. And we aren't alone. Linux distributors and service organizations (like Linuxcare, Caldera®, Red Hat, SuSE and Turbolinux®) and the vast, global Linux programmer community combine to offer strong support for the platform.

MYTH: Linux isn't secure.

FACT: Linux is just as secure as other operating systems. You don't have to take our word for it. Take the word of the world's foremost security organization, the National Security Agency. The NSA is investing resources to develop and promote high-security mechanisms in Linux. They chose Linux because of its growing success and open development environment.

MYTH: Linux doesn't really save money.

FACT: The fact that Linux is free (or is available for a nominal fee) is a very small part of the overall cost-efficiency of Linux. Through workload consolidation and the wide availability of Linux-skilled programmers, Linux solutions can cut all kinds of costs.

The Weather Channel's Web site, weather.com, is the world's leading source of online weather information. During weather crises, traffic soars to 40+ million page views in just days. weather.com needed a cost-effective platform on which to quickly add capacity and handle wildly fluctuating traffic. They chose Linux running on IBM xSeries Intel-based servers for their Web, application and database needs. The Linux platform resulted in a 70% cost savings over other platform options, as well as lower incremental growth costs.

BOTTOM LINE: The facts are clear: Linux is here and Linux is ready. Ready for business. Ready for e-business. Ready for the enterprise. For more facts or help with Linux, call us at 1 800 426-7777, Priority Code 101DY021, or go to ibm.com/linux/cio2



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GETTING FEVERISH ABOUT DRUG PRICES

Your remarkable article, "Drug prices: What's fair?" (Cover Story, Dec. 10), is one of the few probing journalistic attempts to grapple with the dilemmas of affordable medications and research financing. The marginal cost of manufacturing pills (after the research is performed and the factories built) has generally been very low cost. But with patents, mergers, and efforts to hold back generics, drug prices are not determined by anything close to a free market.

It is sad to see artificially high prices restrict the use of the many medications that are needed—especially with 70 million Americans lacking drug coverage and millions more insured badly. Private cost controls would cut drug use further, and they might even hamper research.

The latest data show that per capita drug spending here is the world's highest. As we outlined recently in Senate testimony, a prescription drug peace treaty could rely on public action to lower prices and raise volumes to buy all the additional drugs needed to fill all Americans' prescriptions, at an annual incremental cost of perhaps \$9 billion, while protecting drugmakers' profits and while channeling dollars from marketing and copycat research into breakthrough research.

Alan Sager and Deborah Socolar
 Directors, Health Reform Program
 School of Public Health
 Boston University
 Boston

You ask: "Drug prices: What's fair? Whatever the market will bear."

Fred Dent
 Baton Rouge, La.

The U.S. is one of the few countries that doesn't place government-control price restrictions on drugs. This makes for an uneven playing field, in which insurance companies and patients supply the profits and research of the pharmaceutical industry, while the world reaps the therapeutic benefit—at considerable

lower expense. International pharmaceutical company self-regulation of drug prices would be a step in the right direction.

William Hummel, M.D.
 San Diego

A large but hidden part of the problem is the pricing of generic drugs. Typically, they cost 20% less than the name brand—just enough to qualify for most insurance plans and not enough to

roll the big manufacturers. But it is still far more than the actual costs of production. In theory, with research and development costs amortized, the cost of many drugs should be pennies. Brand manufacturers could themselves take the lead in low-cost manufacturing (and selling).

Don Hutchins

Sudbury, Mass.

Big Pharma may spend billions advertising to consumers, but it knows its bread and butter comes from physicians writing prescriptions. Some companies resort to blatant bribery—to get caught. Others offer lavish, all-expense-paid vacations to resorts and



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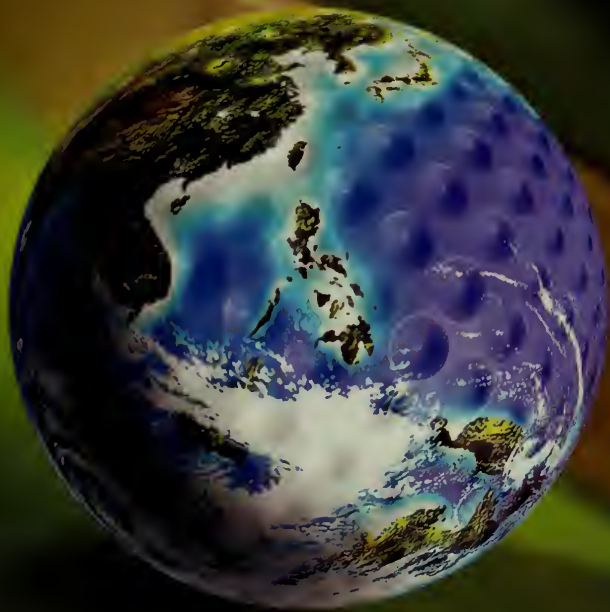
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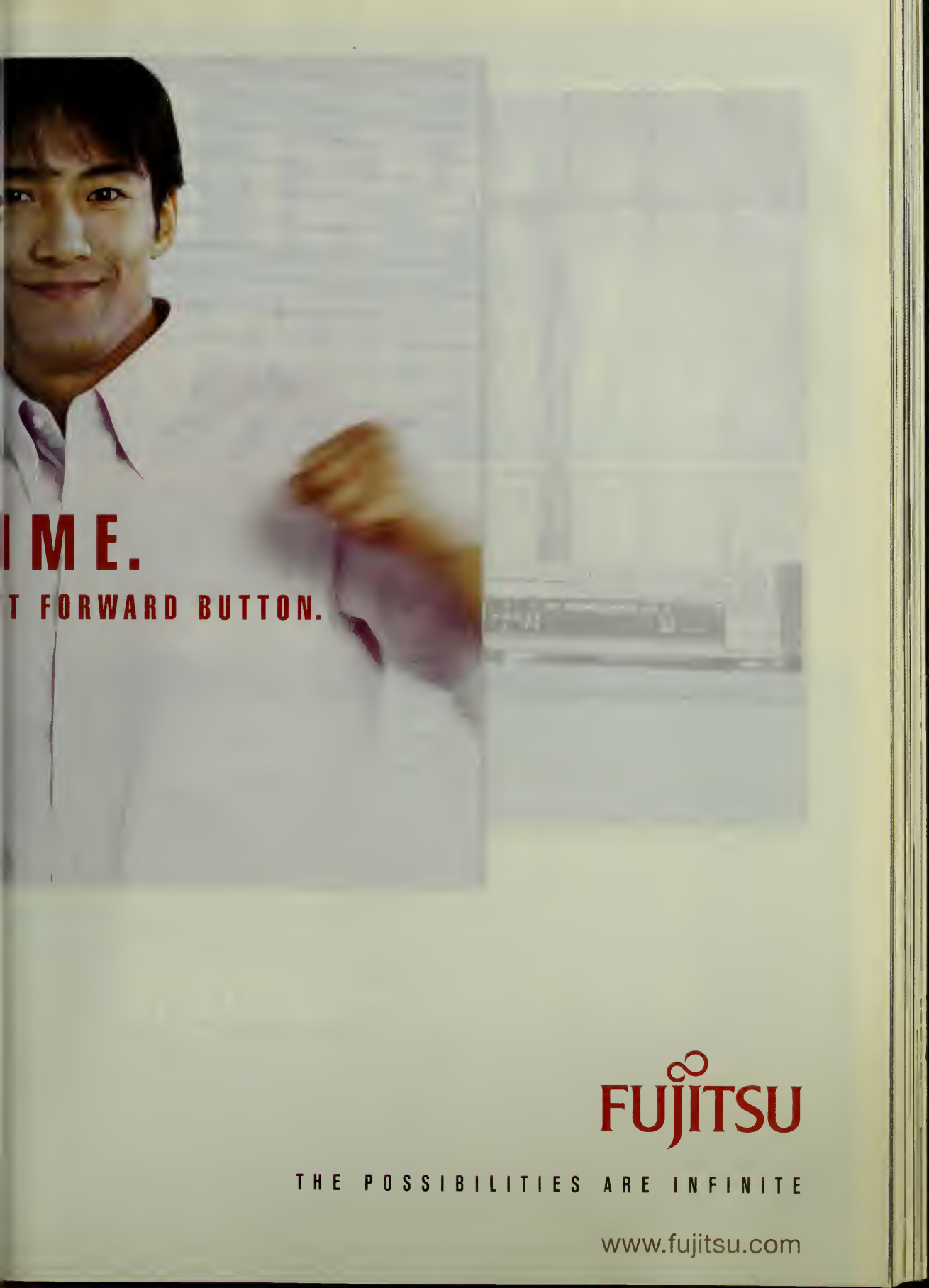
As a product developer at JVC,
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Readers Report

CORRECTIONS & CLARIFICATIONS

BusinessWeek incorrectly reported that MasterCard International would be a sponsor of Fox's Feb. 3 telecast of the Super Bowl (In *Business This Week*, Dec. 17). Although an advertiser in previous telecasts, MasterCard is not buying ad time for this year's game.

the premise of a "product launch," along with expensive "promotional materials." I certainly don't fault pharma companies and doctors for making money, but if they agreed to curb these practices, drug prices would surely be lower.

Wanda Opdyke
South Plainfield, N.J.

What companies would jump through all the expensive hoops that the Food & Drug Administration has instituted to bring a new drug to market just to break even or make a small profit? Not many. The truth is that pharmaceutical companies want the payoff from their investment in drug research, and U.S. investors (especially venture capitalists) want stock returns in their portfolios. That is why the American people and

the U.S. government tolerate the health-care industry being run as a business. Ultimately, high drug prices—and high profits—are good for the economy.

R.J. Myer
Temecula, Calif.

The intellectual-property protection granted to drug companies should require payment of a fee that would be based on the actual sales of the patented item (usually a drug) during a first period of its commercial use. The proceeds from this fee should be collected in a fund that would finance the required service—vaccinations, medical care for the poor, or basic research at universities. The fee would apply only to those patents that are actually commercially used, and would be due after they are commercially used for a long enough period of time. Such a fee can avoid potential problems of patents whose owners visualized no commercial use at the time of filing, such as the gene-sequencing patents.

Nicholas Georgakopoulos
Carmel, Ind.

It was inspiring to see an article about drug costs utilize the input of

pharmacists. Recent pharmacy graduates have all completed some coursework in the discipline of pharmaceutical economics. Many complete additional residency and fellowship training. It is time for the American health system to recognize the important contribution of pharmacists in the care of patients and the management of drug costs.

John Michael O'Brien, Pharm.D.
Bethesda, Md.

Medicine works only if used properly. Misuse of prescription drugs costs the health-care system \$1.25 on top of every dollar that is spent on medication. Of the remedy for misuse of prescription drugs is only more prescription drugs. Community pharmacists can help reduce many of the misuses. Considering the \$100 billion annual cost of prescription drugs, it is clear that there is a great deal of room for improvement.

Craig L. Fulmer, President & CEO
National Association of Chain Drug Stores
Alexandria, Va.

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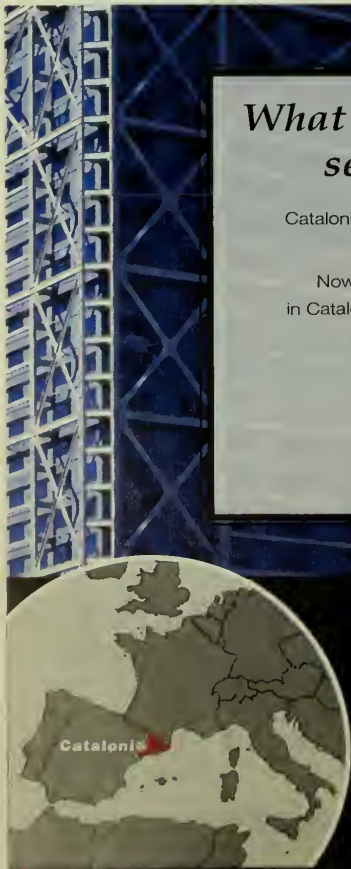
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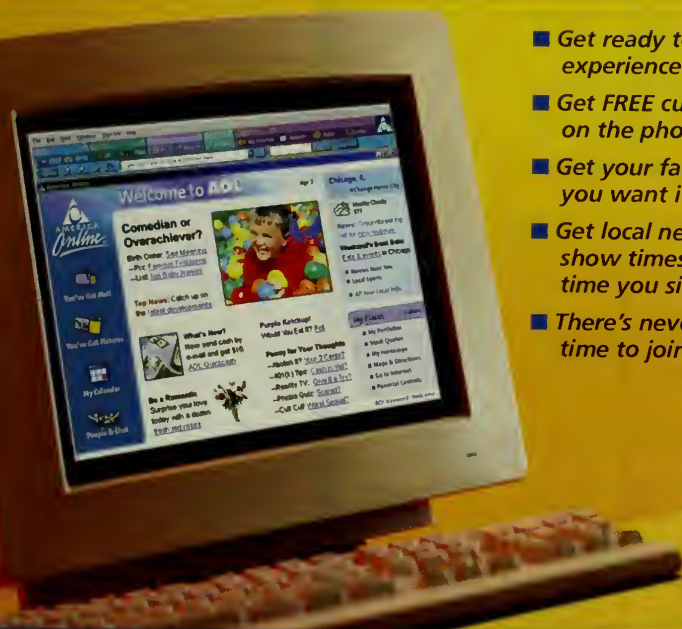


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Readers Report

rather than "health promotion." That backwards! Increasingly, health-care resources will be consumed by our aging population, the very folks who can least afford the high prices. Physicians, insurers, and administrators must design benefit plans with a conscience: don't regulate unnecessary drug utilization (and the attendant cost of drug misadventures in the elderly) while fully funding appropriate nutritional and pharmaceutical therapy.

Michael D. Levin
Health Business Strategist
Clackamas, OR

NO SNIDE CRACKS ABOUT DOT-COMS, PLEASE

In "E-biz is flunking out on campus" (e.biz, Dec. 3), you quote Raphael Anderson, director of the Wharton Electronic Business Initiative as saying: "E-biz is not something separate." Then comes your snide comment: "Now he tells us." This is truly a case of the pot calling the kettle black.

During the bubble period, *Business Week* was totally sucked in by the dot-commers. You completely lost your objectivity. Your reporting skills were reduced to slobbering over companies and "entrepreneurs" that were promoting untenable business models. Shame on you: You should have known better. And because so many people rely on your insights, you must bear some moral responsibility for their investment losses when the bubble burst.

Please return to the kind of analytical insights you are capable of generating, e.g., the excellent summary of the issues in "The Microsoft case: Tying it all together" (Legal Affairs, Dec. 3).

Louis W. Stein
Kellogg School of Management
Northwestern University
Evanston, IL

QUESTIA: REVOLUTIONARY? NOT TO A LIBRARIAN

Stephen Wildstrom's article "Bringing the stacks to the students" (Technology & You, Dec. 10) gives the impression that Questia Media's digitized book collection is a revolutionary work for college students to research papers. Wildstrom should have visited a few academic libraries to see how they've changed—any one of them will have an array of electronic databases that will put Questia to shame.

Librarians are tech-savvy, human search engines who are highly skilled at finding information on the Internet.

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Steven J. B.
Director of the Library
Philadelphia University
Philadelphia

WHERE TEACHING RANKS ON THE STATUS SCALE

It's a telling commentary that teaching becomes a popular career choice for the well-educated only when they can't find work elsewhere ("Going to the head of the class," *Social Issues*, Dec. 1). The 2 million teacher shortage that is forecast to develop over the next decade is largely confined to math and science. Candidates with these areas of expertise will be easily marketable outside the teaching profession once the economy revives. When that happens, there will be a mass exodus.

Walt Gardner
Los Angeles

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CROSSING OVER

A Mexican Family on the Migrant Trail

By Rubén Martínez

Metropolitan Books • 330pp • \$26

THE GRAPES OF WRATH, MEXICAN-STYLE

One April dawn in 1996, a truck jammed with 27 undocumented Mexican migrants flipped over and crashed in California as the driver tried to escape arrest by the U.S. Border Patrol. Among the eight killed were three brothers from the Chávez family of Cherán, a small village in central Mexico, who were on their way to Watsonville to pick strawberries. The crash made headlines but was soon forgotten—little surprise, considering that 200 to 300 Mexicans have died each year since, attempting to sneak into the U.S.

The accident, however, captured the imagination of Rubén Martínez, a grandson of Mexican immigrants. To find out why so many Mexicans abandon everything familiar to embark on a dangerous voyage to an often hostile country, the California journalist proceeded to spend 18 months commuting between Cherán and U.S. cities where migrants live. He befriended the Chávez family and others in Cherán, accompanying them to concerts, bullfights, and bars and listening to their stories.

The result is an engrossing chronicle of migrants' lives. *Crossing Over: A Mexican Family on the Migrant Trail* is sure to become a favorite in university courses on the migrant experience. It is a sympathetic portrait of people who risk their lives, endure long separations from their families, and eventually change the character of their villages when they return—bearing money, new values, and new customs.

Martínez' book is timely, appearing as Washington rethinks its approach to the estimated 4.5 million illegal Mexican workers toiling in the U.S. economy. During a state visit in early September, Presidents Vicente Fox and George W. Bush created a bilateral commission to consider a possible amnesty for illegal aliens and the expansion of a guest-worker program. But the September 11

attacks cast a chill. Border security was tightened just as the U.S. slowdown was forcing legions of migrants to return to Mexico. Many Americans now are more suspicious of immigrants.

Still, the overall acceptance of Mexican migrants has grown. They take jobs at rock-bottom wages that most Americans don't want—and during the booming 1990s, the extra hands were much appreciated. Today, even the AFL-CIO supports immigration reform, eager to recruit Mexican workers at a time of dwindling union membership. Latinos are now the country's largest minority, and more than half of them trace their roots to Mexico.

Martínez, an associate editor at Pacific News Service, delivers a visceral picture of life in poor, rural Mexico that makes it clear why Mexicans migrate. With U.S. jobs paying 10 times what Mexicans can make at home—if jobs even exist in their villages—staying in Mexico is simply not an option for most. As he says, "the future is in America, the past in Mexico."

Martínez focuses on Cherán, population 30,000. But he could be describing any number of villages where most adult males have bolted for the U.S., leaving behind families, sometimes for years, wiring them \$150 to \$200 once or twice a month. The migrants pick tomatoes in Arkansas, fix plumbing at Colorado ski resorts, build furniture in North Carolina, and harvest grapes in Oregon. It's a symbiotic relationship: The U.S. needs them, and Mexico needs the \$8 billion they send home annually.

With a storyteller's eye for color, the author describes the virtues and vices of small-town Mexico, from the close-knit

families to the heavy-drinking despair of jobless men. Cherán, a farm town with no local industry, has been forever changed by returning migrants, who cruise around in American vehicles blasting hip-hop music.

Most migrants dream of returning home with enough savings to open a business. But many settle in America, altering the social fabric of towns such as Norwalk, Wis. (population: 500), where 12 members of the Enríquez family toil six days a week at the Val Pride meatpacking plant. Around 70% of the plant's 250 employees are Mexicans doing hazardous jobs that most locals shun. The Enríquez family drives Cherán for the annual fiesta in a fleet of five 1989 Chevy Silverado trucks. They own houses in Norwalk and in Cherán. The family patriarch longs to retire in Mexico, but Martínez doubts he will.

"Home," he says, "is beginning to look more like Wisconsin."

Martínez doesn't provide a policy-wonk argument for easing immigration controls. *Crossing Over* is more of an impressionistic portrait, with observations that at times border the fantastic: Do we really believe that pigeons in Mexico City succumb to pollution and fall out of the sky? On occasion

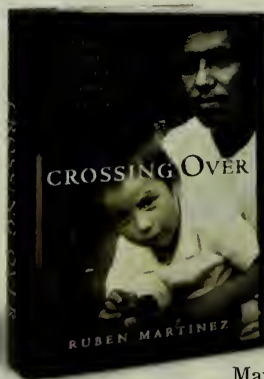
Martínez seems to deviate

from the book's main point, as when he spends page after page describing local witchcraft traditions and the antics of drunken, itinerant bullfighters.

Still, he excels at telling the story through Mexican eyes. President Clinton calls Mexico's migrants "heroes" for providing the country's third-largest source of foreign revenue. While pushing for amnesty, he's also trying to create jobs in towns that send the most people to the U.S. But that may be pie in the sky: Until wages in Mexico improve, it's inevitable many will go north. Indeed, that's the path chosen by María Elena, the Chávez clan matriarch, a few years after her three sons' deaths she borrows money from Martínez to pay a smuggler to help her join the rest of her family in St. Louis.

BY GERI SMITH

Smith is Mexico City bureau chief.



WITH A STORYTELLER'S EYE FOR COLOR, MARTINEZ FOLLOWS THE MIGRANTS NORTH



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The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST	PAPERBACK BUSINESS BOOKS			LAST MONTH	MONTHS ON LIST
1	JACK Jack Welch, with John A. Byrne (Warner Business • \$29.95) <i>GE's ex-chairman reflects on his life and accomplishments.</i>	1	3		1	RICH DAD, POOR DAD Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$15.95) <i>Teach your kids the rules of money that the rich play by.</i>	1	3	
2	WHO MOVED MY CHEESE? Spencer Johnson (Putnam • \$19.95) <i>Learning to accept change.</i>	2	35		2	THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Fireside • \$14) <i>Habitually popular.</i>	2	82	
3	FISH! Stephen C. Lundin, Harry Paul, John Christensen (Hyperion • \$19.95) <i>Motivate employees the Pike Place Fish Market way.</i>	3	15		3	THE ONE MINUTE MANAGER Kenneth Blanchard, Spencer Johnson (Berkley • \$12.95) <i>Management techniques in story form.</i>	5	63	
4	GOOD TO GREAT Jim Collins (HarperBusiness • \$27.50) <i>How run-of-the-mill companies make the leap to excellence.</i>	4	2		4	REAL ESTATE RICHES Dolf De Roos (Warner • \$17.95) <i>Why it's better to put money in buildings than to stash it in stocks.</i>	--		
5	FIRST, BREAK ALL THE RULES Marcus Buckingham, Curt Coffman (Simon & Schuster • \$26) <i>A Gallup probe into managerial success.</i>	5	31		5	THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William D. Danko (Pocket Books • \$7.99) <i>The simple ways of the wealthy among us.</i>	12	39	
6	NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • \$26) <i>Bolster your true talents.</i>	6	10		6	RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$17.95) <i>Move from job security to independence.</i>	7	20	
7	THE ROAD TO WEALTH Suze Orman (Riverhead • \$29.95) <i>Questions and answers from the queen of personal-finance counseling.</i>	8	5		7	GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • \$14) <i>A Harvard team's step-by-step guide to conflict resolution.</i>	4	77	
8	THE AGENDA Michael Hammer (Crown Business • \$27.50) <i>Nine notions to fuel success in the customer economy.</i>	12	2		8	J.K. LASSER'S YOUR INCOME TAX 2002 J.K. Lasser Institute (Wiley • \$16.95) <i>It's time for 1099s and W-2s.</i>	--		
9	TWIN TOWERS Angus Kress Gillespie (Rutgers University Press • \$26) <i>The politics, physics, and popularity of the World Trade Center.</i>	10	3		9	THE 9 STEPS TO FINANCIAL FREEDOM Suze Orman (Three Rivers • \$13.95) <i>Learn to save.</i>	9	17	
10	SWIMMING ACROSS Andrew S. Grove (Warner • \$26.95) <i>Intel's chief on his youth in Hungary and escape to the U.S.</i>	--	1		10	1001 WAYS TO REWARD EMPLOYEES Bob Nelson (Workman • \$10.95) <i>Some ideas: a champagne brunch, casual dress day—or plain old cash.</i>	3	58	
11	THE TIPPING POINT Malcolm Gladwell (Little, Brown • \$24.95) <i>What turns an idea into a hot trend.</i>	14	21		11	THE LEXUS AND THE OLIVE TREE Thomas L. Friedman (Anchor Books • \$15) <i>Globalization and its discontents.</i>	6	12	
12	NICKEL AND DIMED Barbara Ehrenreich (Metropolitan • \$23) <i>The lives of the working poor.</i>	11	2		12	BUILT TO LAST James C. Collins, Jerry I. Porras (HarperBusiness • \$16) <i>How 3M, Wal-Mart, and others became standouts.</i>	8	47	
13	GUNG HO! Ken Blanchard, Sheldon Bowles (Morrow • \$20) <i>A look at how Walton Works No.2 fired up its employees.</i>	7	32		13	RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki, with Sharon L. Lechter (Warner • \$19.95) <i>Becoming rich, not merely comfortable.</i>	13	16	
14	THE 21 IRREFUTABLE LAWS OF LEADERSHIP John C. Maxwell (Thomas Nelson • \$22.99) <i>A minister's down-to-earth rules.</i>	9	14		14	THE GOAL Eliyahu M. Goldratt, Jeff Cox (North River • \$19.95) <i>How to eliminate bottlenecks.</i>	15	20	
15	RAVING FANS Ken Blanchard, Sheldon Bowles (Morrow • \$20) <i>Turning customers into your biggest boosters.</i>	13	39		15	WHEN GENIUS FAILED Roger Lowenstein (Random House • \$14.95) <i>Inside hedge fund Long-Term Capital Management.</i>	--		

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Reviews and more are available on AOL (Keyword: BW) or www.businessweek.com

ON THE RISE

IT'S PROBABLY SAFE TO SAY THAT Stephen Hawking's 1988 *A Brief History of Time* is the least-read best-seller ever. But it was wildly successful. Hawking, a professor of theoretical physics at Cambridge University, has subsequently achieved mythic status, appearing on *The Simpsons* and *Star Trek: The Next Generation*, where he played chess with a holographic Albert Einstein.

His new book, *The Universe in a Nutshell*, like *Brief History*,

has made a quantum leap in sales. The topics addressed are fascinating: a review of Einstein's theories, the nature of black holes, and whether time travel is possible. Yet his insights remain inscrutable. In the chapter on time travel, for example, he writes: "One might dispute whether closed-loop particle histories have anything to do with the warping of spacetime, because they occur even in fixed background such as flat space." Some might dispute it. But I wouldn't.

BY PAUL RAEBURN

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EUROPEAN CENTRAL BANK

BY STEPHEN H. WILDSTROM

tech+you@businessweek.com

WHAT STEVE SEES ON TECH'S HORIZON



Watch for the rise of home networking, PC and Net entertainment systems, and broadband

The year now ending is one a lot of people, especially in the high-tech industry, will be happy to put behind them. But while the economy remains shaky and many segments of the industry are reeling, there are a number of reasons to look forward to a brighter 2002.

One reason for my optimism is that coming months are likely to see some of the important trends that have been building for years finally come to pass. The most important of these in personal technology are the convergence of computers and entertainment and the growth of truly useful wireless data networks.

Few notions have spawned as much silliness, or wasted as much money, as convergence. After all the hype, it turns out that people don't want to surf the Web on TV sets or watch movies on their PCs. And TV viewers remain couch potatoes, with little desire to interact with what they see on the screen. Instead, convergence is sneaking up on us from another direction: the delivery of Internet content to audio and video systems in a networked home.

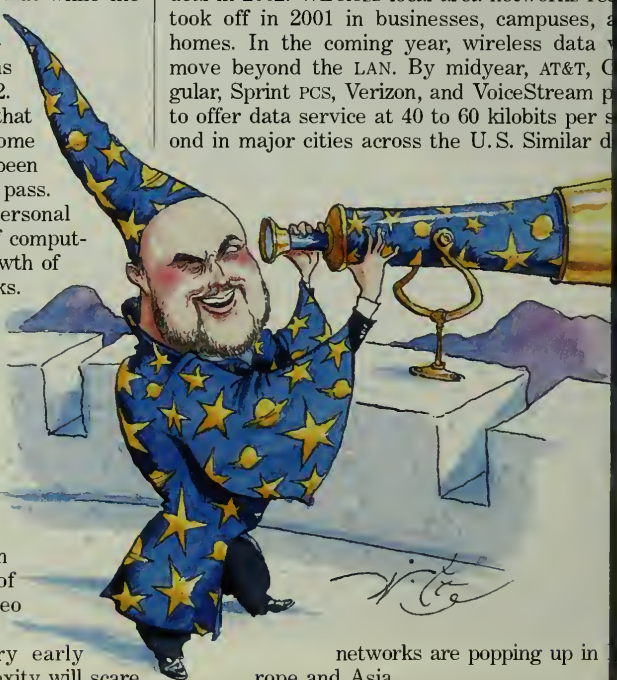
This trend is still in its very early stages, and high prices and complexity will scare off all but early adopters for a while. But the pieces are falling into place for a mass market explosion. The first is home networking, especially wireless Ethernet. In the past year, the cost of wireless networking has been cut by half with the introduction of \$200 combination gateways and base stations from companies such as Linksys, 2Wire, and Netgear. If only setting up a network were as simple as it is cheap. Despite a lot of progress, much remains to be done to make the technology accessible. I also see a huge business opportunity for service providers that can install and manage home networks.

The next step is attaching entertainment systems to these networks. This is beginning to happen. Hewlett-Packard, Compaq Computer, SONICblue, and Kenwood all make units that link audio systems to music available on PCs or the Internet. You can use your computer or dedicated equipment to select from a display of title and track information on prerecorded audio CDs and DVDs. These will be among the most interesting products of 2002, and I will be writing

about them in coming weeks and months.

Entertainment over the Internet requires high-speed connections—and will give many consumers a reason to want broadband. It's been a dreadful year for the broadband industry, with DSL phone service, particularly, in a shambles. But cable companies have gotten much better at deploying broadband quickly and cheaply, with many consumers able to install service themselves. Even the collapse of cable Internet service provider Excite@Home looks more like a bump in the road than a disaster, as cable companies learn to run their own networks.

The advance of wireless data will also be a deal in 2002. Wireless local area networks really took off in 2001 in businesses, campuses, and homes. In the coming year, wireless data will move beyond the LAN. By midyear, AT&T, Cellular, Sprint PCS, Verizon, and VoiceStream plan to offer data service at 40 to 60 kilobits per second in major cities across the U.S. Similar developments



networks are popping up in Europe and Asia.

Because of display and data-entry limitations, high-speed data is of little use on a phone. Instead, all sorts of new devices will take advantage of the networks. PC Cards for laptops will be first, followed by add-ons for Palms and Pocket PCs, and finally, integrated wireless handhelds—a course similar to that followed by wireless LANs. Bluetooth, a long-delayed short-range wireless technology, will begin to allow laptops and handhelds to connect without cables. Phones that can then link to the data network.

Of course, many of the trends we saw in 2001 will continue. Computer price declines will slow, but that trend remains inexorably downward. And following the great dot-com shakeout, serious business people are focusing on online businesses that can provide value to their customers and profits to their owners.

This has been a trying year in many ways for all of us. With a little luck, the year to come will be a much better one. I thank you for your readership, and share the hope that 2002 will be a year of health, prosperity, and peace.

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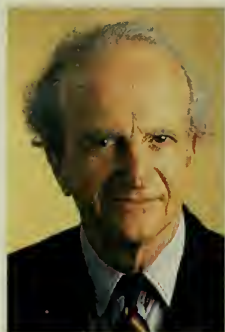
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BY GARY S. BECKER

AMERICA WILL LEAD THE WORLD BACK TO GROWTH



OPTIMIST:
The Fed's
actions
and the
great inner
strengths
of the U.S.
economy
will bring
an end
to this
recession
in 2002

Gary S. Becker, the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution.

America's economy and those overseas have gone through an enormously difficult and complex year, highlighted by the terrorist attack of September 11 and the weakening of the world's economy. What will 2002 and beyond bring? Economists are not good at being predictors of short-term economic conditions, but I see a bright future after cranking up my crystal ball.

I am confident the aftereffects on the American economy from September 11 will not be large. The rapid success of the U.S.-led war to destroy the Taliban regime in Afghanistan and to break the al Qaeda terrorist network has greatly boosted morale not only in America but also in Europe, judging from a recent visit I made to celebrate the 100th anniversary of the Nobel prize.

The pain to families and others from the loss of life on September 11 is dreadful and can never be forgotten. While valuable property was also destroyed, it amounted to a tiny portion of the physical resources of the U.S. A slightly more rapid rate of investment in plants and equipment for less than a year will quickly bring the physical capital stock beyond its previous heights. Fortunately, the knowledge possessed by the American people, the main engine of modern economic growth, remains largely intact. To be sure, the effects on New York will last longer, but that great city, too, will recover and gain strength.

Turning now to the American-led world recession, let me share the following thoughts. The American economy during the 1990s was the locomotive of the global economy, which explains why its recession spread to Europe, Asia, and beyond. Since I believe the economic impact of the terrorist attack will be small, world economic performance in 2002 and beyond will primarily depend on how rapidly the U.S. pulls out of its prolonged, although not severe, recession. Fortunately, the Federal Reserve, under Alan Greenspan's leadership, has taken early and repeated steps to reduce interest rates and to raise the rate of growth of the money supply and liquidity.

These actions, along with the great inner strengths of the American economy—human capital and entrepreneurship—will bring this recession to an end during 2002. How soon is hard to predict, but I do not expect it to last beyond the first two quarters of the year. Although industrial production has declined for about a year, the effect has been smaller than in the past,

since industry now accounts for a much smaller share of aggregate American output. And the slowdown of industrial output may already be largely over.

The service and construction sectors have held up, and while unemployment has climbed rapidly, it still is under 6%. This is rather good, considering that not long ago, economists believed 6% or even 7% were full employment levels for a modern economy.

Some commentators have feared that the American economy during the coming decade will duplicate the weak performance of Japan during the 1990s, since both countries had excessively booming stock markets and rapid rates of investment. But I believe this comparison is erroneous because these economies differ in fundamental ways. The Fed has moved far more quickly than the Japanese did, not only to lower interest rates but also to increase the rate of growth of the money supply and liquidity.

Moreover, the Japanese banking system was and remains fundamentally unsound, with negative net worth for some large banks. By contrast, most American banks and other financial institutions are in good shape, and can readily expand credit and equity. The U.S. economy, although overregulated, is highly flexible compared with Japan's, especially in services and construction.

The Japanese authorities tried fiscal stimulus, but these efforts utterly failed to jump-start that economy and raised the ratio of public debt to gross domestic product to a very high level. There is similar pressure in Congress to use the excuse of the American recession to increase public spending and cut taxes to curry the favor of important interest groups.

I do not believe that either tax cuts or greater public spending are useful ways to promote short-term recovery. Indeed, they could hinder recovery if they are misplaced. To discourage future terrorism and other conflicts, and to stimulate long-term economic growth through greater rates of investment and entrepreneurship, I support larger defense spending, a flatter income tax, and lower taxes on capital.

I often see the glass as half empty, but not today. I believe 2002 will bring renewed economic growth not only in the U.S. but also in Europe, Asia, and elsewhere. The main risk is not any inherent weakness of advanced economies or even future terrorist attacks, although these must be guarded against. The risk lies in misplaced public spending and tax actions that do more harm than good.



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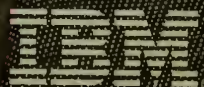
A close-up portrait of Nacho Dominguez, an IBM Development Executive at Telecom. He is a middle-aged man with dark hair, wearing glasses and a grey suit jacket over a light-colored shirt. The background is a plain, light-colored wall.

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NACHO DOMINGUEZ, IBM Development Executive, Telecom

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BY MICHAEL J. MANDEL

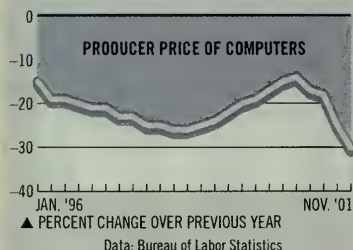
WHY HIGH TECH MAY RALLY

Steep price drops spell more sales

Tech investment is still slumping, as companies cut back on spending during the recession. Moreover, many analysts are predicting that the tech doldrums will continue well into 2002.

Nevertheless, there's at least one indicator that suggests tech investment may revive faster than expected. The

COMPUTER PRICES ARE PLUMMETING



positive sign: The price of computers, adjusted for quality and computing power, has plummeted at a 34% annual rate over the past six months. By contrast, in the year before that, computer prices fell at only a 17% rate. Similarly, the price declines in telecom equipment have accelerated since spring.

By themselves, these price declines won't create a new boom, given how much companies spent on technology in the 1990s. But they are good news for tech investment. Historically, tech sales accelerate when the price of computing power is dropping fastest, since companies are more likely to invest when they can get more computer for less money. This dynamic reflects not just lower prices but also faster innovation.

For example, the information-technology spending spree of the 1990s started in 1995, which is precisely when the quality-adjusted price of computers began dropping like a stone. Indeed, leading economists, such as Dale W. Jorgenson of Harvard University, argue that it is this fall in computer prices that triggered the New Economy investment boom and productivity surge.

By contrast, during times of slow price declines, new purchases of information-technology equipment often flag, as computers and communications gear

seem like less of a bargain. During the late 1980s, a period of relatively weak growth in technology spending, the price of computers fell at only a 9% rate.

It may be coincidence, but the current tech slump started in the second half of 2000, at a time when computer price declines slowed dramatically. And over that full year, the price of the broad category of information technology gear, including communications equipment, barely fell at all. One possible reason is that demand was so strong that capacity utilization in high-tech manufacturing reached a mighty 89%, giving tech companies the mistaken belief they could keep prices high.

Now, of course, the lack of demand is forcing big price cuts. And judging by the past, that may eventually make tech purchases more appealing to buyers.

SECURITY AS A TRADE BARRIER

Transport delays will raise costs

The explosion of global trade in the postwar era is usually attributed to the lowering of tariffs and other trade barriers. But a recent paper by David L. Hummels, an economist at Purdue University, suggests that there may be another reason for globalization: the dramatic reduction in the time that freight spends in shipment. New security measures that slow down the passage of goods across borders may therefore have a much bigger impact on trade than expected.

Hummels points out that 50 years ago, all overseas trade went by ship. Since then, the use of air freight for high-value, time-sensitive goods has soared. Moreover, the shift to containers has substantially reduced the average transit time of ocean-shipped goods.

Hummels argues that time in transit is a big impediment to trade. And faster transport makes it possible to outsource high-tech goods, such as computers, which typically travel by air. "If you manufacture computers to order, you can't do it if the computer is going to be on a boat for four weeks," he says.

By examining trade patterns, Hummels calculates that reducing time in transit by one day is equivalent to reducing the price of the product by 0.8%. Thus, the shift from a 20-day ocean shipment, the average today, to a one-day air shipment, for example, is equivalent to cutting roughly 15% from the price of a product.

Hummels' research implies that post-September 11 security could impose big cost. For example, suppose security checks on incoming goods add a day's shipping. With manufactured imports running at over \$800 billion dollars a year, the extra day is equivalent to \$80 billion in added costs. "You could be talking about very serious expenses if goods are subject to even minimal scrutiny on the way in," says Hummels.

THE THREAT OF A HUGE DEBT LOAD

Balance sheets are really sagging

An imponderable of this recession is how corporations will deal with their heavy debt loads. Since the downturn started in the first quarter, nonfinancial corporations have issued new bonds by the truckload, driving up the total debt by \$137 billion. By contrast, during the 1990-91 recession, nonfinancial corporate debt rose only \$5 billion.

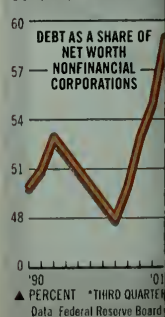
Optimists argue that this time, companies were able to take on new debt and refinance old debt at low interest rates, making it less worrisome. Indeed, interest paid is less than 4% of nonfinancial corporate output, compared with 6% during the last recession.

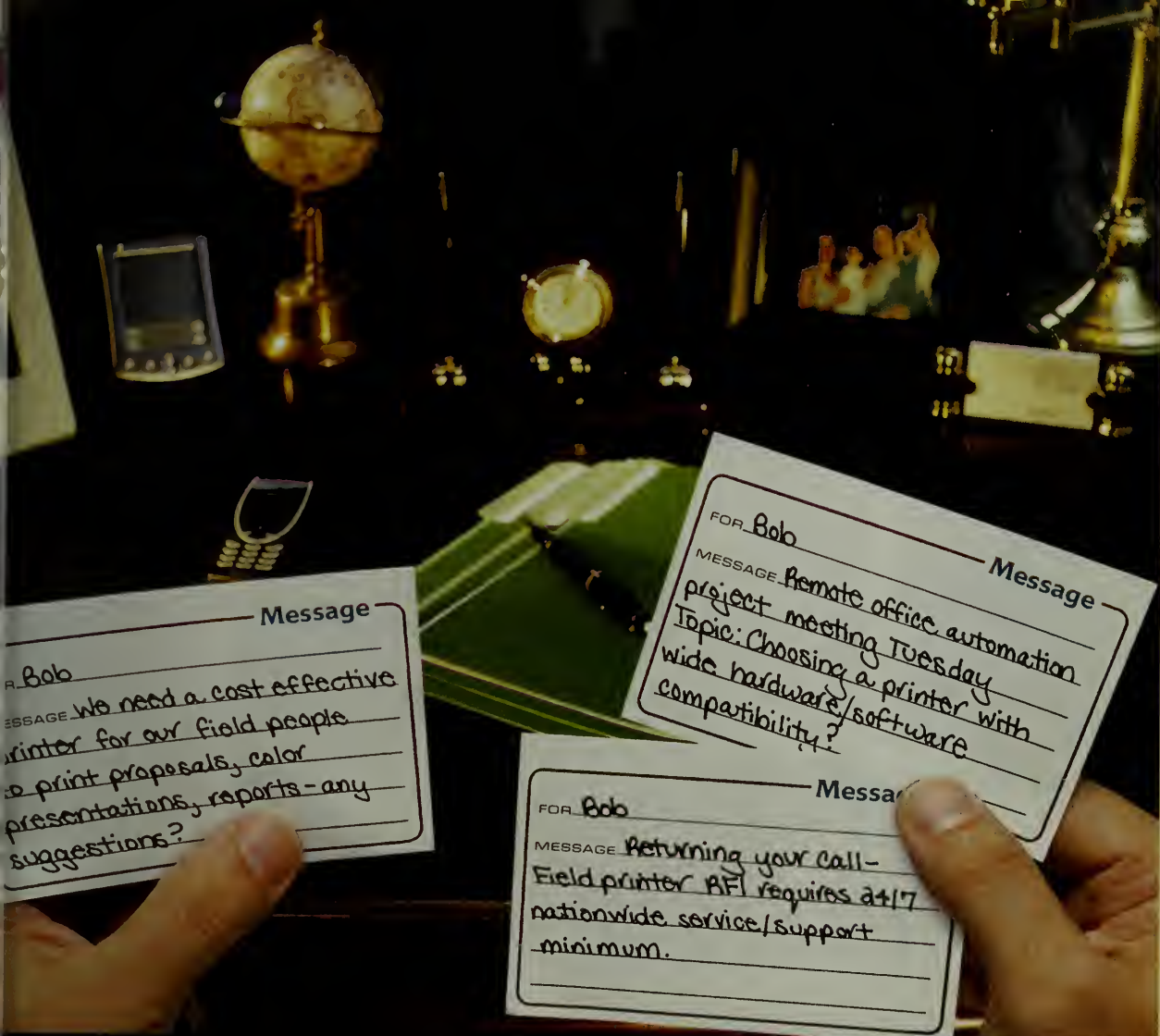
Nevertheless, new data from the Federal Reserve Board raise questions about corporate balance sheets. Nonfinancial corporate debt as a share of net worth now stands at 59%—a record level. Moreover, that's up from 54% a year earlier, the biggest four-quarter jump ever. By comparison, the ratio of debt to net worth at the end of the 1990-91 recession was only 51%.

The high level of debt compared with net worth reduces the financial cushion of companies and makes them more vulnerable to unexpected shocks. For example, if inflation falls more sharply than expected and companies can't raise their prices, that debt will be harder to repay.

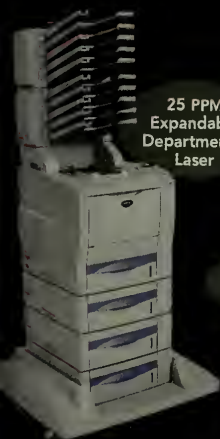
Spotting vulnerabilities in a financial system ahead of time is never easy. But it would be more reassuring if Corporate America was not borrowing quite so much.

THE HEAVY BURDEN OF CORPORATE DEBT





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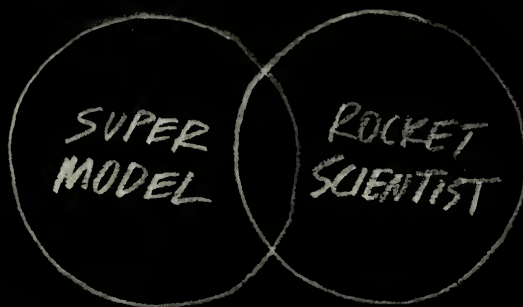
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JAMES C. COOPER & KATHLEEN MADIGAN

NEW SIGNS OF LIFE THROUGH THE FIRST QUARTER

Consumers and inventories are canceling each other's effect on GDP

U.S. ECONOMY

As 2001 draws to a close, an economic recovery is more forecast than fact. The latest data show that industrial activity is still falling, retailers are bemoaning lackluster sales, and businesses are laying off workers in the face of poor profits and dim prospects for the future. Economists in general believe that the recession will end in the first quarter of 2002 (page 66). That prediction, however, is based mainly on policy efforts and hopeful indicators that bode well for the outlook. So far, no evidence of better times remains elusive.

A RECORD SHRINKAGE IN STOCKPILES



Michigan's index of consumer sentiment edged up in December for the second month in a row. The major consumer-attitude measures from both Michigan and the Conference Board remain well above the levels plumbed during the 1990-91 recession.

Most important, the impact on economic growth of the dramatic inventory liquidation in 2001—necessitated by previous bulges in autos and tech equipment—may reach its nadir by yearend (chart). Keep in mind that, in the accounting of gross domestic product, the change in inventories determines the level of GDP, but it is the magnitude of that change from quarter to quarter that terminates the inventory sector's contribution to GDP growth. For example, if businesses cut their stockpiles by \$10 billion in one quarter and then by a lesser \$60 billion the following quarter, that counts as a \$20 billion increase in the latter quarter's GDP.

THE FOURTH-QUARTER LIQUIDATION

will clear the way for a pickup in output in 2002. It also points to a key development for the fourth and first quarters: consumer spending and inventory growth are neutralizing each other's effect on GDP growth, leaving the weakness in capital spending and exports to dominate the economy's performance. Consequently, real gross do-

mestic product in the fourth quarter is likely contracting as fast, or perhaps faster than, its 1.1% drop in the third quarter.

Watch the industrial sector to see this dance between consumers and inventories. Industrial activity started to fall six months before the recession began in March, and manufacturing has accounted for the lion's share of this year's job losses. Industrial production gave the first signal that demand was softening, and it will be a key barometer for the recovery.

In November, the output data were mildly encouraging. Even though industrial production fell 0.3% during that period, with manufacturing output down 0.2%, the drop-off was much smaller than in recent months.

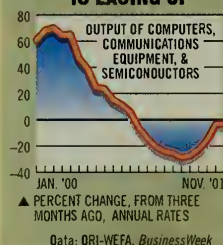
Moreover, the report brought good news from the tech and auto sectors, where inventories needed substantial realignment with sales in 2001. The November 0.6% drop in output of tech equipment continued the string of smaller tech-output losses that began in July. Tech equipment makers may be getting a better grip on their inventories: Their inventory-sales ratio has fallen for two months in a row. Clearly, the tech sector is still in trouble, but its drag on economic growth in the second half of 2001 was far less than in the first (chart).

FOR AUTO MAKERS,

generous incentives worked like magic to cut inventories and boost sales. The huge consumer response to zero-rate financing cleared out dealer inventories so fast that November stockpiles were the lowest for that month since 1993. Auto makers responded to dealers' empty lots by boosting production by a steep 6.4% in November, and more increases may be on the way. Even if sales in December fall as expected, carmakers will still have to initiate some inventory replacement, says *Ward's Automotive Reports*. Already, some manufacturers are upping their production plans for the first quarter.

That will be a plus for first-quarter real GDP. For the fourth quarter, though, autos will lead yet another huge liquidation in overall business inventories. The third-quarter liquidation was the largest in the postwar era, but the fourth-quarter decline will most likely be

THE DRAG FROM TECH IS EASING UP



even greater—a big subtraction from GDP growth.

That was clear from October's inventory data, which showed a record 1.4% plunge in stocks held by manufacturers, wholesalers, and retailers. But it was the 2.8% drop in retailers' inventories, reflecting a steep decline in autos, that told the story. Because of cars, inventory liquidation is set to subtract one to two percentage points from fourth-quarter GDP growth.

CONSUMERS, MEANWHILE, are doing their best to add to GDP growth. Retail sales surged 6.4% in October and only fell back 3.7% in November. Almost all of the swing reflected October's record pace of car sales followed by more modest sales in November. When that turnaround—and the price-related drop in gasoline sales—is excluded, a more stable trend in store-buying emerges (chart). Indeed, fourth-quarter real consumer spending is growing at a rate of 2% to 3%.

However, that pace will barely be strong enough to offset the drag from inventories, and the only other sources of strength are government and housing. Home starts unexpectedly jumped 8.2% in November, although much of the gain was influenced by unusually mild weather. The nation's homebuilders reported that sales activity in December picked up, but housing's contribution was likely small in the fourth quarter. Add in declines in capital spending and a slightly wider trade gap, and real GDP will almost certainly

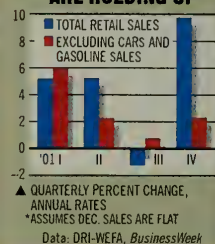
post its second straight decline in the fourth quarter.

Will the first quarter also see a decline in real GDP? Expected increases in government spending—for rebuilding efforts and defense—will probably offset another decline in capital spending. Weather will determine housing's performance this winter, while the slowdown in demand, both in the U.S. and overseas, will likely hold the trade deficit steady.

Again, that leaves consumers and inventories as the key to the first-quarter outlook. Most assuredly, car sales will drop this winter, possibly resulting in the first decline in consumer spending of this recession. But with car production scheduled to pick up, the thrust from vehicle inventories will turn positive—and may be large enough to enable the total inventory change to add slightly to economic activity.

Considering all of these factors, real GDP may well be about flat in the first quarter. In normal times, that would be a very disappointing performance. Since it will follow two consecutive drops in activity, though, consumers and businesses alike will welcome an economy that is simply holding its own, with the promise of better times not far away.

WHERE RETAIL SALES ARE HOLDING UP



ISRAEL

TERRORISM ZAPS THE ECONOMY

Already hit by the Palestinian uprising—the *intifada*—and the global high-tech slowdown, the Israeli economy was dealt a further blow by the September 11 attacks in the U.S. Now, the most recent surge in Israeli-Palestinian violence is causing more layoffs and business disruptions.

The once-booming high-tech sector has been especially devastated. Weaker U.S. and European demand has led to a sharp 11% drop in tech exports, the first yearly decline on record. Hundreds of local startups have either shut down or been forced to trim their payrolls. More mature technology businesses have also downsized. In addition, the *intifada*

has hurt other parts of the economy. Thousands have been laid off in recent months in the tourism, construction, retail, and old-line manufacturing sectors.

As a result, the unemployment rate is rising sharply after holding relatively steady in recent years (chart). In the third quarter, the number of unemployed topped the record level of 1991, when huge numbers of immigrants from the former Soviet Union came to Israel.

Real gross domestic product is on track to grow less than 1% in 2001. For 2002, economists forecast that unemployment will top 10% by yearend and real GDP will rise by 2% at most.

JOBLESSNESS IS ON THE RISE



The Israeli government is facing a tough task in countering the rapid downturn. Falling tax receipts have forced an upward revision of the planned budget deficit to 3% of GDP. But to meet even the revised target, the government has to cut the budget by \$1.5 billion.

So far, the central bank's monetary policy has not helped matters much, either. Even with inflation in check, the Bank of Israel is keeping its key lending rate well above the U.S. Federal Reserve's target rate.

A recovery in the U.S. and in other Western economies is expected to lead to a partial improvement. But only a marked change in the Israeli-Palestinian situation will likely bring about a full-scale recovery.

By Neal Sandler in Jerusalem



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A SMARTER SQUEEZE?

To lessen layoffs, some companies are cutting pay and benefits

At the height of the late '90s boom, DiamondCluster International Inc. paid whatever it took to recruit and retain workers for its tech consulting practice. The Chicago-based firm lavished staffers with stock options, bonuses, and perks, including a private performance of Cirque du Soleil. But with the tech collapse causing a drop in demand for DiamondCluster's services, the company asked many of its 1,400 employees to give back some of their gains; indeed, workers making more than \$50,000 were required to take as much as a 20% pay cut. Management's share-the-pain approach didn't sit well with many workers who, with their stock options already underwater, say the cuts hit too hard. "People are lying low, but when the economy improves they'll be out of here," says one senior associate.

The discontent inside DiamondCluster reflects one of the biggest management challenges that corporations have had to face in years. After a decade of doling out signing bonuses, stock options, and other perks like candy during the go-go '90s, a generation of managers is wrestling with an issue many have never faced before: how to run their businesses and maintain worker morale at a time when many companies are facing fierce pressure to rein in costs.

With the labor shortages of the late '90s still fresh in their minds, many corporate leaders are taking a new tack in the first recession of the New Economy: Rather than opting only for the sweeping layoffs of the past, which often require managers to hastily rehire when the economy recovers, companies ranging from Hewlett-Packard Co. to Charles Schwab Corp. are trying to limit layoffs by freezing or cutting pay across the workforce.

At the same time, huge cost pressures have put benefits on the block too: Ford Motor Co. and Lucent Technologies, among others, recently cut back their matching contributions to salaried employees' 401(k) retirement plans, for example, while Delphi Automotive Systems Corp. also temporarily halted a program that gave salaried workers as much as \$1,250 for each child in college. If the recession drags on, the cuts "could get a lot worse," says Steven E. Gross, a compensation consultant with William M. Mercer who predicts that as many as half of all major corporations could cut or freeze pay and benefits in the coming year, up from a third this year.

Still, many management experts warn that by imposing across-the-board cuts in pay and benefits, moves that touch far more workers than traditional layoffs, executives could be creating big morale problems: Many workers may

perceive the moves as a management ploy to take back some of their hard-earned gains of the past decade. That could serve as a drag on productivity during the downturn—and a catalyst for massive defections down the road. "When the economy strengthens, these companies will have hell to pay when their better employees leave," says Robert Morgan, president of the human resources consultant with Spherion Corp.

Some companies who imposed pay cuts in the past now say they would never do it again. Way back in 1987, managers at General Electric Corp.'s struggling electric-motor division canceled a scheduled \$1.30-an-hour raise for line workers and instead slapped them with an 11% pay cut. While the moves generated \$25 million in savings, GE admits that worker morale—and productivity—plummeted. "That one has never been forgotten," warns William J. Conaty, a senior vice president of corporate human resources.

Many recruiters and management experts argue that companies would be better off biting the bullet by laying off their least-productive workers, while being careful to lavish enough on truly valued employees to ensure they stick around. Salary and benefit cuts "are the

PRESSURE POINTS

As the downturn takes its toll on profits, many companies are imposing new rollbacks on workers who survive layoffs.

Data: William M. Mercer, Watson Wyatt, Hewitt Associates

* According to a survey of 100 large companies

PAY



Roughly one-third of big companies are reducing raises, delay freezing bonuses, more than half cutting bonuses. Others are cutting salaries outright.



Many management pros warn that these moves could create big morale problems

thing you want to do in a down economy," warns Jeff Christian, chairman of Christian & Timbers, a leading executive search firm. "It's never good to get anything away from the people you want to keep."

Still, many companies say they can't afford to single out stars. Instead, they're going to great lengths to cushion the impact of the widespread cuts. At companies like Micron Technology Inc., Tribune Media and even DiamondCluster, top executives are taking larger sacrifices than

they're asking of employees—a gesture that's helped convince some of the rank-and-file that they're all in this together. Others are giving stock options to offset the pay cuts. After trimming the pay of every worker earning more than \$25,000 by 5%, database management company Axiom Corp. granted stock options to the affected workers as an inducement to stay. "Whatever we can do to retain talent, we're going to do it," says Cindy K. Childers, Axiom's leader for organizational development.

Other companies are restoring small perks that workers missed most, or doling out other precious goodies that don't cost the company money—especially more free time. It seems petty, but workers at Agilent Technology, which imposed a 10% pay cut, were delighted that their favorite gourmet tea was restocked in some office pantries. And at Management Recruiters International Inc., which

isn't paying a holiday bonus this year, managers are making new efforts to accommodate worker requests for more flexible schedules—and shorter weeks. "People aren't working as insanely," notes MRI spokeswoman Karen Bloomfield.

And though it may sound trite, managers find that employees are more willing to accept cutbacks as long as someone takes the time to clearly explain why such measures are crucial to the company's well being. At Rosenbluth International, a Philadelphia-based travel agency, chief executive Hal Rosenbluth found that a series of staff meetings smoothed the way for 10% pay cuts in the wake of September 11. The real purpose of the meetings: to let staffers vent. Says Rosenbluth: "I wanted to let people throw eggs at me."

But such gestures may not be enough to assuage workers in high-demand sectors like technology, finance, and entertainment. With the talent shortage causing salaries to shoot into the stratosphere in the late '90s, some companies are exploiting the current downturn to bring pay levels back to prior levels. And that brings management hurdles of its own. In the late 1990s, with many studios racing to replicate Walt Disney Co.'s phenomenal success with *The Lion King*, average salaries for animators soared from \$70,000 to \$200,000—and to upwards of \$1 million for star animators.

But with many studios having since pulled back, companies such as Disney are slashing salaries to as much as 30% below current levels as contracts come up for renewal. "This was a cost structure that had gotten out of hand," says Thomas Schumacher, head of Walt Disney Animation. "We are still offering attrac-

CARE Ford Motor, Visteon, and other corporations are passing rising health-care costs on to workers through higher deductibles and larger co-payments.



RETIREMENT



Some employers, including General Motors and Lucent Technologies, are scaling back matching contributions to workers' 401(k) retirement programs.

PERKS



Say good-bye to catered lunches, concierge service, and at-desk massages. These and other such boom-time niceties were among the first cuts made.

tive salaries. We just don't have to bid them up the way we had to a few years ago." Predictably, that isn't sitting well with some animators. "It's pretty dehumanizing to be told, 'You're very good but we can always go out and find someone to do it for less,'" says one animator, who is now looking to join a rival studio.

Finding a new job in a recession, of course, isn't always an option. At Tera-

dyne Inc., a Boston-based maker of chip-testing equipment that recently asked workers to take their second pay cut of the year, Vice-President of Corporate Relations Tom Newman is betting the recession will keep workers in place for now. "This will sound bad, but there are not a lot of good choices around," notes Newman. As long as that's true, managers have little to worry about. But

once the job market takes off again will be a different story. That's what smart managers are doing all they can keep their employees happy during dark days of economic winter.

By Dean Foust in Atlanta, Michelle Conlin in New York, with Paul Burrows in San Mateo, Calif., Patrick Keenan in Boston, Roger O. Crockett in Chicago, and bureau reports

COMMENTARY

By Aaron Bernstein and Michael Arndt

UNITED: A PEACE MISSION THE WHITE HOUSE SHOULD SKIP

Is the Bush Administration making bad labor relations at United Airlines Inc. even worse? The No. 2 carrier's tempestuous dealings with its unions have left many workers distrustful of management and in no mood for concessions. The conflict was due to come to a head on Dec. 21, when a federally mandated cooling-off period ends and United's 15,000 mechanics are free to strike.

A solution looked possible in late November, when United and the International Association of Machinists sketched out a plan to cope with the airline's woes. Management would show its good faith by giving mechanics the 25% pay hikes on the table before September 11. That was in line with hikes other United employees had already received. Both sides would then negotiate concessions.

But United balked in early December, company and union insiders say. The reason: It became clear that the White House saw even temporary raises as inappropriate, given the \$781 million in federal aid United is now getting. A spokeswoman for the White House says it didn't realize that United and the IAM had come close to a deal. And according to United Senior Vice-President for Human Resources William P. Hobgood, "we do recognize the situation that the IAM is in, and we will continue in



ROUGH FLIGHT

Losses United's fourth-quarter losses could hit \$1.44 billion, excluding charges.

Cuts It has cut roughly 20% of its flights and employees, retired 84 planes, and is postponing delivery of more.

Cash The company is burning through \$15 million per day.

Data: United Airlines, Salomon Smith Barney

every way we can to find a solution."

Now both sides are waiting for the feds to solve their problem. The White House vowed to appoint a Presidential Emergency Board by Dec. 21, which would avert a strike for 60 days. Both sides expect a PEB to endorse concessions United wants, not only from mechanics but also from its other 65,000 employees, who with machinists own 55% of parent UAL Corp.

The likely result: United will get cost cuts, but at the price of worse labor relations. They're already among the industry's poorest, as was clear when pilots snarled flights during a mid-2000 pay dispute. "We understand the need for concessions, but first we have to level the playing field with other employees," says Machinist leader Scotty Ford.

While it's not clear that the abort-

plan would have worked, it held more promise than the imposed settlement now in the offing. Days before September 11, United had all but clinched a labor pact to lift the machinists' \$25 hourly wage—among the lowest in the industry—closer to the \$34 mechanics earn at No. 1

American Airlines Inc.

The terrorist attacks threw that idea off course. United has since slashed about a fifth of its work-

NO HELP NEEDED from an imposed labor settlement

force and accepted emergency aid to help stem the red ink. In October, CEO James E. Goodwin was replaced by board member

John W. Creighton Jr., largely at the insistence of fed-up union members.

In late November, United and the IAM decided to push through the pay hike agreed to before September 11. In return, the mechanics would give up some or all of their pay hike until the airline's fortunes improved. The deal was also meant to deflect the ire of Congress, which had just bailed United out. Even some analysts don't see a need for cuts, since United has slashed capacity to bring it in line with lower sales. "It's unrealistic to expect a long-term reduction in wages," says UBS Warburg analyst Samuel C. Buttrick.

Some analysts say that with passengers trickling back, the carrier will return to profitability by 2003 with no labor concessions at all. Of course, that's a long time to wait, so it's understandable that Creighton wants to curb costs. But if he lets a PEB impose a deal on his unhappy workers, the new CEO's first victory may be a Pyrrhic one.

Bernstein watches labor in Washington and Arndt covers United from Chicago.



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HEWLETT'S LAWYER

“Walter was led to believe the deal was going to get approved by this board no matter what he did”



HP INSIDER

“There was never a gun put to Walter's head”

MERGERS

WALTER HEWLETT: BEHIND HIS BIG SWITCHEROO

Why he O.K.'d the HP deal with Compaq—then fought it

Why did Walter do it? While plenty is known about Hewlett-Packard Co.'s troubled bid to buy Compaq Computer Corp., that central question still remains. Why did HP board member and founding family scion Walter B. Hewlett vote with HP's board to O.K. the deal on Sept. 3 only to turn around on Nov. 6 and publicly oppose it? That now-famous reversal has spawned a heated proxy fight that threatens not only the merger but the very tenure of HP CEO Carleton S. Fiorina. Why didn't Hewlett just oppose the deal in the boardroom to try to save HP from the carnival that has since ensued?

Sources close to Hewlett insist he felt he didn't have a choice. After voicing his concerns for months about the deal and its impact on his family's huge charities, he was shocked, they say, to learn at a board meeting just days before the deal was announced that the merger agree-

ment called for unanimous board approval. When Hewlett raised objections, the sources claim he was told the deal would go through with or without his support, though unanimity would ensure a better reception from shareholders.

Since the companies were then in the throes of working out the final stock-exchange ratios, Hewlett's associates say he feared HP would get less favorable terms if the unanimity provision in the merger agreement was deleted. That concern, combined with guidance from HP legal adviser Larry W. Sonsini that he could later oppose the deal by voting his shares against it, the sources say, led Hewlett to begrudgingly vote with the board at the final balloting on Sept. 3. Says Hewlett's lawyer, Cooley Godward partner Stephen C. Neal: “Walter believed the deal was going to get approved by this board no matter what he did.”

Sonsini and HP vehemently deny they put any undue heat on Hewlett. “We do not believe that he was pressured,” says Sonsini. “Walter is an independent thinker and an experienced board member. He knows very well what his fiduciary duties are: to vote in the best interests of the shareholder.”

Still, mergers-and-acquisitions experts say Hewlett's support should have been far more solid for HP to proceed with this risky deal. The deal's size and the poor history of tech mergers made it a long shot from the start. Given his famous

family name—and its huge stake—HP needed to win Hewlett's heart, felt support, not just his signature. “If you know Wall Street is likely to be skeptical, then you make sure your principal shareholders are going to be supportive,” says M&A expert Dennis J. Block, a partner at Cadwalader, Wickersham & Taft.

The crucial board meeting at which Hewlett felt he was pushed into backing the deal, according to the sources, occurred on Thursday, Aug. 30, at the offices of Wilsons Sonsini, Goodrich & Rosati, HP's law firm. Shortly after Sonsini read aloud the language about the board's unanimous support, source

familiar with the proceedings say Hewlett spoke up and said, “I can't do this. You know my views. Do you realize what an awkward position you've put me in?” HP insiders say they don't recall such an exchange.

According to one Hewlett colleague, the meeting then adjourned for a break. Sonsini allegedly told Hewlett he would not be able to stop the deal. After spending the weekend in Lake Tahoe agonizing over how to vote, the sources say, Hewlett went along with the board at the final vote on Monday, Sept. 3. But they say he also told the board he had already decided to vote against the deal. HP insiders deny he said this. Says one: “There was never a gun put to Walter's head, as far as I know.”

HP insiders say Sonsini wasn't trying to pressure Hewlett to vote for the deal but was simply stating that the merger would be better received with a unanimous board than without one. They also adamantly deny that HP gave him any reason to fear the deal would have to be renegotiated on less favorable terms if the agreement had to be redrawn because the company couldn't deliver unanimous board approval. But the board clearly was determined to proceed. “We probably would have gone forward anyway,” says one insider, rather than let a single director scotch the deal. Whether that will ultimately prove to be a wise decision, however, is still far from settled.

By Peter Burrows in San Mateo Calif., with Andrew Park in Dallas

By Ben Elgin

DON'T BELIEVE THE YAHOO! HOOPLA

When new Yahoo! Inc. Chief Executive Terry S. Semel swooped in on Dec. 12 with an unsolicited offer to buy HotJobs.com Ltd. for \$436 million, analysts cooed, calling the move "bold," and portraying the company as a "sleeping giant awakening." After keeping a low profile in his first six months on the job, Semel is now revealing his strategy: Yahoo will move beyond its model as an ad-dependent assembler of Internet content and begin to own and develop its own properties and services.

And its recent flurry of announcements, including the hostile bid for HotJobs and the acquisition of music site LAUNCH Media Inc. in June, has investors hopping. Yahoo's stock is up 127% in the past three months, to \$18.38. Like many tech shares, "there's a recovery expectation built into the stock right now," says Thomas Weisel Partners LLC analyst Gordon Hodge.

Still, amid all the recent Yahoo hoopla, giddy investors seem to be ignoring one key point: Yahoo's turnaround is far away. Any recovery hinges on Semel's efforts to diversify its business and cut costs further. Yet even in the rosiest scenarios, his moves are a long way from paying off. Assuming Yahoo wins HotJobs, the career site would be hard-pressed to deliver profits. In the first nine months of 2001, it lost \$21.3 million on revenues of \$92.5 million.

Nor are Yahoo's financials any better. Revenues, 80% of which still come from on-line ads, are expected to shrink 39% in 2001, to \$700 million. And after posting profits in 2000, the company has suffered operating losses of \$87.5 million through the first three quarters of 2001 and is expected to post another \$35.8 million loss in the fourth quarter, according to John Coreoran, an analyst at CIBC world markets.

CEO SEMEL: Yahoo's share price has risen 127% in three months

So how does combining two money-losing companies create a winner? Yahoo argues that the synergies between the companies would make the HotJobs deal profitable within 6 to 12 months. Still, it's unclear how exactly that will happen. Deal proponents claim that access to Yahoo's

YAHOO!

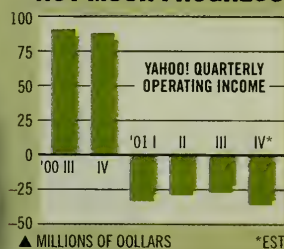
210 million monthly visitors could help HotJobs increase its exposure and reduce its advertising budget. Combining Yahoo's own job site with HotJobs would boast 8 million resumes. But that pales beside market leader Monster.com's 14 million resumes and \$50.7 million in operating profits in its latest quarter.

Nor is Yahoo's \$12 million purchase of the No. 10 music site, LAUNCH Media, in June, any more promising. Yahoo gets more content, including a large collection of music videos. But LAUNCH was a teetering also-ran before Yahoo bought it, and so far Semel hasn't turned it around. In its last stand-alone quarter, LAUNCH posted \$14.2 million in net losses on revenues of \$3.8 million. To make his mark in online music, Semel needs to build its subscription service through his partnership with Universal Music Group and Sony Music Entertainment Inc. But whether or not that can deliver profits is anybody's guess.

Clearly, Semel has been dealt a challenging hand. Even with the current rally, Yahoo's market valuation has shrunk 92%, to \$10.5 billion, over the past two years, making surefire acquisition targets too pricey. But in areas such as cost control, where Semel exerts greater control, he could do more. In November, Yahoo announced it would cut 300 jobs. But that's merely a scratch for a company that boasts 65% more employees and 48% higher operating costs than the last time quarterly sales were at around \$160 mil-



NOT MUCH PROGRESS



Data: Bloomberg Financial Markets, CIBC World Markets

lion, back in September, 1999. With no upturn in Net advertising in sight, Semel faces a tough future. Getting his new deals to pan out while pulling the plug on money-losing units is about his only option. Until he does, Yahoo's recent Wall Street run really is too good to be true.

Elgin covers technology from San Mateo, Calif.

DEFENSE

THE PENTAGON'S HIGHEST-FLYING HAWK

His vast connections make Paul Wolfowitz a formidable player

Deputy Defense Secretary Paul D. Wolfowitz isn't a Muslim, isn't considered a friend of the Arab world, and argued in favor of U.S. forces pressing the attack in Afghanistan during Ramadan. So guests at a Pentagon *Iftar* dinner—the communal meal that breaks the fast each day during the Islamic holy month—might have been excused for wondering what he was doing as the featured speaker.

Nevertheless, the audience of 50 listened politely as Wolfowitz noted that America had defended Muslims six times in the last decade, from the Balkans and Iraq to Somalia and Afghanistan. And it's no secret that Wolfowitz dearly wants to add a seventh campaign to the list: a new drive to end the rule of Saddam Hussein.

Wolfowitz is arguably the fiercest hawk in the Bush Administration, and his dustups with Colin Powell's more cautious State Dept. have made headlines as debate rages over where the war on terror should head next. Despite the obstacles to unseating Saddam, no one is counting Wolfowitz out. "Anytime Paul Wolfowitz speaks, it's like E.F. Hutton: Everybody listens," says Deputy Secretary of State Richard L. Armitage, a longtime associate and

says Yan Xuetong, director of the Institute of International Studies at Tsinghua University in Beijing.

The current frenzy over Iraq leaves the soft-spoken Wolfowitz a bit unsettled. For one thing, it's too early to talk about marching to Baghdad, he insists. "I would not be at all surprised if next

clear strategy, which calls for a reduction in nuclear warheads and construction of missile shield.

As one of a tiny group of foreign policy gurus who guided then-Texas Governor George W. Bush during the campaign, Wolfowitz argued that with the end of the cold war, the emphasis should be shifted away from mutual assured annihilation. He even advocated slashing nuclear arsenals. In fact, the cuts the Bush team has proposed, roughly 2,000 warheads, are what the Clintonites sought for a third strategic arms reduction pact.

On the other hand, Wolfowitz is one of the architects of Bush's withdrawal from the Anti-Ballistic Missile Treaty, considered by many Democrats to be the cornerstone of arms control. D



“The notion that wealthy people like bin Laden are moved to become terrorists because of poverty is, well, it's a joke on its face” — PAUL D. WOLFOWITZ

now one of the pragmatic ex-soldiers at State who sometimes clash with the more hawkish academics and corporate managers at Defense.

Wolfowitz' position on Iraq was forged long before September 11: He advocated helping oust Saddam in 1991 and was one of the first voices to favor taking on Serb dictator Slobodan Milosevic. Wolfowitz also hews to a hard line on the need to defend Taiwan against a possible invasion from China. "When anything happens, he always assumes that it must be solved by the U.S. military,"

spring or summer, we are still seeking terrorists hiding" in Afghanistan, Wolfowitz told *BusinessWeek* in a Dec. 18 interview.

In truth, Wolfowitz, 58, is far more than an anti-terror hard-liner. The former dean of Johns Hopkins' School of Advanced International Studies has been tapped by Defense Secretary Donald H. Rumsfeld to kick-start the Pentagon halting efforts to transform itself into a 21st century fighting machine. And he has established himself as the intellectual godfather of the Bush Administration's nu-

spite predictions of a cataclysmic reaction by Russia, China, and allies to the withdrawal, the response has been muted, except in Washington. "I think Wolfowitz is very bright. I think he's honest. I think he's wrong," says Senate Foreign Relations Committee Chairman Joseph R. Biden (D-Del.).

But even those who disagree with him note that Wolfowitz's experience and knowledge make him a formidable opponent. Wolfowitz' service to six administrations has included three tours of duty at the Pentagon, beginning in t

arter years, when he focused on Persian Gulf rivalries after the fall of the Shah of Iran; two jobs at State, where he helped oust Philippines dictator Ferdinand E. Marcos; and an ambassadorship to Indonesia, the world's largest Muslim nation.

One key to Wolfowitz' influence is that he engages colleagues with a loose, Clintonesque management style, encouraging debate rather than rapid decisions. "I often found myself in his office thinking, 'Paul, it's time to throw me out,'" says one ex-aide. "But the result he always has a leg up on the other principals at the table who haven't thought through the ideas to their second and third order of consequences."

That style has helped build a loyal cadre that has fanned out throughout the administration, giving Wolfowitz enormous bureaucratic clout. His former aides include Deputy National Security Advisor Stephen J. Hadley; Zalmay M. Khalilzad, the National Security Council's director for South Asia; Vice-President Dick Cheney's top two national secu-

ENGAGING: Wolfowitz' style encourages debate

rity aides, I. Lewis "Scooter" Libby and Eric S. Edelman; and Air Force Secretary James G. Roche.

This time around, Wolfowitz chose a top job at defense instead of state. "Trying to bring the military into the 21st century is too much to resist," he says. But Wolfowitz could fast become a lightning rod for the military brass, defense contractors, and Congress if he guts some pet programs that aren't working. On Dec. 14, for example, the Pentagon axed an overbudget Navy missile defense system for ships that was much beloved by some Star Warriors: they hoped it would be the base for a national missile shield.

The Brooklyn-born Wolfowitz isn't poiling for a fight—at the Pentagon or overseas. In fact, he prefers deterrence as a management tool and in foreign policy. He believes "you should be the guy nobody wants to screw with," an associate says. "You have a lot fewer problems." And he is persistent. "If he gets an idea and thinks something is right, he will stay with it," says a top Administration official. That's the sort of determination that could make for some sleepless nights in Baghdad.

By Stan Crock, with Paul Magnuson, in Washington and Dexter Roberts in Beijing

COMMENTARY

By Ronald Grover

WHAT VIVENDI UNIVERSAL REALLY NEEDS IS NBC

The code name they chose for the deal was Tier One. So when USA Networks Chief Executive Barry Diller and his Vivendi Universal counterpart, Jean-Marie Messier, unveiled their \$10.3 billion deal to merge USA's cable channels and TV studio with Vivendi's Universal film studio, no mystery existed as to where it is these two moguls want to go. Their goal: to catapult Vivendi Universal, once a little-known French water utility, into the upper strata of media companies. Yet for all the hoopla about Barry Diller's heading a Hollywood studio again, no one will soon confuse the new company with the likes of AOL Time Warner, Walt Disney, or Viacom.

Sure, Messier coupled the USA deal with his \$1.5 billion Dec. 14 equity stake in satellite-TV company EchoStar Communications. That gives him a fast-growing launching pad with more than 6 million subscribers so that Diller can create new cable channels. And if EchoStar's planned merger with General Motors Corp.'s DirectTV Inc. is approved, that could grow to 17 million subscribers.

But cable channels by their nature deliver shows to tiny slices of the audience, nowhere near what a powerhouse needs. USA's four cable channels, for instance, are received in 80 million homes. Yet they collectively generate audiences of less than 3 million at any one time for popular shows such as USA's *Walker, Texas Ranger*. By comparison, the WB Television Network gets that many viewers for just its lowly rated show *Raiding Dad*.

Which is why Diller admits that Vivendi Universal Entertainment is "a work in progress" that could des-

perately use a TV network to deliver large numbers of eyeballs. The economics of the media business today require vast audiences to cover the enormous costs of making movies and TV shows. Enter NBC, which Diller has unsuccessfully tried to buy at least twice in four years. NBC is also the last remaining network not owned by a major media company. Messier also covets NBC, according to sources close to him. Can Diller see NBC being a part of his vision for Vivendi's new entertainment unit? "Absolutely, always," says Diller.

Problem is, NBC isn't for sale. But Diller and Messier may be successful at wrangling a joint-venture deal out of General Electric Co. Since foreign companies can't own TV stations, Vivendi could create a U.S. holding company to hold its stake in the network. For NBC, the economics would be every bit as compelling as for Diller and Messier. Coupling NBC's cable network with Vivendi Universal's cable channels would create a mighty TV

showcase for big-ticket events such as *Harry Potter* and *The Sorcerer's Stone*. Disney snared that film by offering a steep \$70 million, which it hopes to recoup by showing it on both ABC and later on its newly acquired ABC Family Channel.

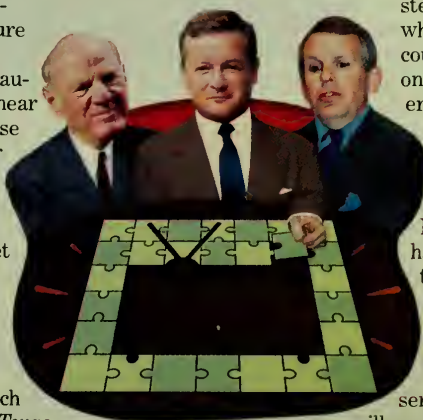
For now, Messier and Diller say they have plenty on their plates. The EchoStar deal lets them develop five new channels on the satellite service. And Diller

will run Vivendi Universal's movie studio, TV studio, and its theme parks in California and Florida. It's a media business, all right, though still a pipsqueak. Still, that's nothing a little Peacock couldn't cure.

With Tom Lowry in New York and Carol Matlack in Paris

MISSING PIECE

Diller, Messier, and EchoStar's Ergen could use a network outlet to recoup program costs



BIOTECHNOLOGY

CAN AMGEN GO TOE-TO-TOE WITH THE BIG BOYS?

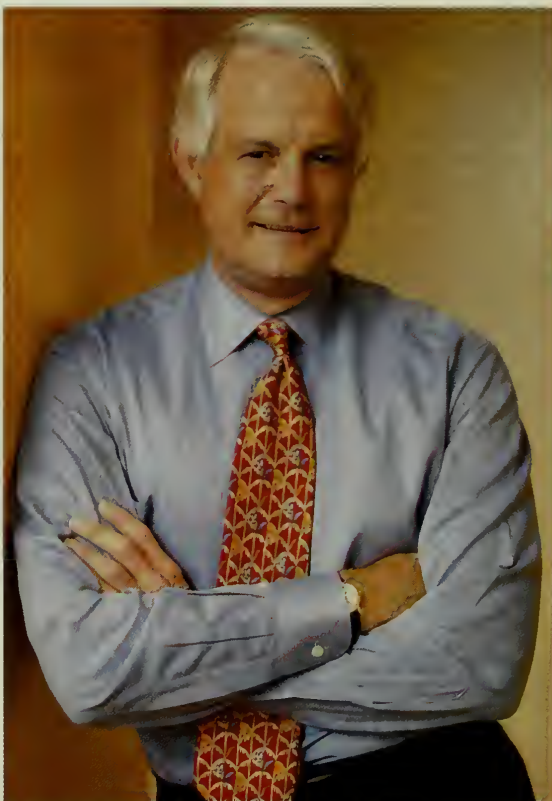
Its \$16 billion Immunex purchase hasn't convinced the Street

When Amgen Inc. CEO Kevin W. Sharer finalized his company's \$16 billion acquisition of Immunex Corp. on Dec. 17, he did more than create a biotech giant with \$5.5 billion in projected 2002 sales. He also ratcheted up a rivalry with Amgen's biggest partner—and foe—Johnson & Johnson.

With its new anemia drug Aranesp, Amgen is already trying to grab share from J&J's blockbuster Procrit. And now with Immunex in its corner, Amgen will nab the \$750 million rheumatoid arthritis drug, Enbrel, which competes head-to-head with J&J's Remicade. "We are entering markets that are intensely competitive," says Sharer, a 10-year Amgen veteran who took over the top spot in May, 2000.

To justify his acquisition—and earn his place in the big leagues—Sharer must now prove Amgen is capable of going toe-to-toe with giant competitors like J&J. He also must solve an Enbrel manufacturing shortfall that threatens the drug's growth while building up weak pipelines at both Amgen and Immunex. And he has got to do all that while integrating the biggest acquisition in biotech history, a task that will inevitably cause some distraction.

Wall Street is nervous. After a rough ride through most of 2001, investors pushed Amgen's shares up 17%, to \$69, this fall after the Food & Drug Administration approved two new Amgen drugs: Aranesp in September and Kineret, for rheumatoid arthritis, in November. They were the first drugs out of the Thousand Oaks (Calif.) company's pipeline in a decade. But its shares have fallen 10%, to \$58, since news of the Immunex deal broke on Dec. 13. Investors were clearly disappointed that the purchase will di-



lute earnings until at least 2004. "There's a lot more risk now," says Samuel W. Murphy III, senior securities analyst for American Express Financial Corp., an Amgen investor.

A particular area of concern is the dogfight with J&J. The advantage of Immunex' Enbrel is that it relieves the debilitating pain of rheumatoid arthritis and doesn't require the toxic chemotherapy drugs that typically are taken with J&J's Remicade. But Enbrel is in short supply, and it will be at least a year before Amgen has enough capacity to fill demand. With more than 350 sales reps pounding the pavement for Remicade, J.P. Morgan Chase & Co. analyst Michael Weinstein estimates J&J's market share has jumped from 35% in early 2001 to about 50%.

And soon after Amgen gets Enbrel production up to demand, it's likely to face competing drugs.

Even before the deal, Amgen had its hands full. The new Aranesp, a potential blockbuster, competes with J&J's \$3.5 billion anemia treatment Procrit which J&J licensed from Amgen in 1985. Aranesp should be a formidable foe: It can be injected much less frequently than Procrit. Still, J&J has put big dollars behind Procrit, doubling the drug's sales force to 600 over the past three years and spending \$33.4 million on consumer ads in the first eight months of 2001. "It's a marketing battle and J&J has more might," warns Viren Mehta, analyst with Mehta Partners LLC.

HURDLES Even if Amgen prevails against Johnson & Johnson, Sharer must build up its weak pipelines

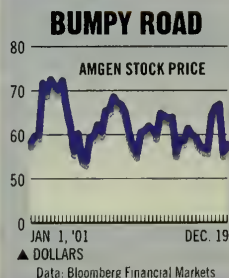
Amgen is fighting back. Analysts expect it to increase its marketing and administrative spending from about 22% of sales in 2001 to at least 25% in 2002. The money will likely go to build its salesforce and launch ads. Amgen is also suing J&J, claiming the company is violating its Procrit license by pushing the drug as an anemia remedy for kidney patients on dialysis—territory owned solely by Amgen. An arbitrator will hear the case early in 2002, and some believe the suit may result in a multibillion-dollar

blow to J&J. "J&J could be vulnerable," says Larry N. Feinberg, managing partner at Oracle Partners LP, a hedge fund that owns Amgen shares.

Even if Amgen prevails against J&J, Sharer will struggle to solve a fundamental challenge: a weak pipeline. He says Immunex strengthens Amgen's efforts to develop new treat-

ments for inflammatory disease, cancer and other conditions. But "the near-term pipeline is sparse" for Amgen and Immunex, says Lloyd S. Kurtz, a health-care analyst at Harris Bretall Sullivan & Smith. Yet another reason Sharer will have his hands full in transforming Amgen into a pharmaceutical powerhouse.

By Arlene Weintraub in Los Angeles and Amy Barrett in Philadelphia





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COMMUNICATION WITHOUT BOUNDARIES

COMMENTARY

By Paul Raeburn

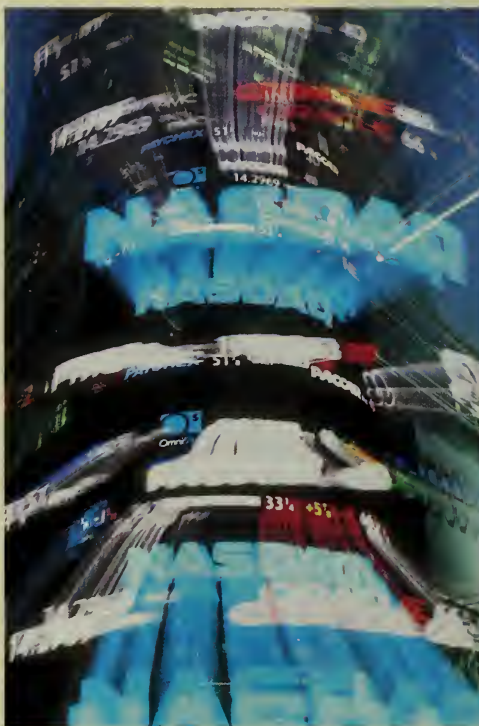
A BIOTECH BOOM WITH A DIFFERENCE

On Dec. 17, biotech stocks got some good news. In the new annual ranking of the Nasdaq 100 index—made up of the 100 largest nonfinancial companies ranked by market capitalization—seven of the 13 companies added were in biotech. The new entrants include such familiar names as ImClone Systems, Cephalon, Sepracor, and Invitrogen; they replace 13 faltering tech, telecom, and Internet outfits, including onetime stars CMGI, 3Com, and Palm. All told, biotech companies now represent 12.7% of the market capitalization of all the companies in the index, nearly triple the share they held only two years ago. “It is a reflection of the growth sector of the economy,” as well as huge investor interest in biotechnology, says John L. Jacobs, president and chief executive of Nasdaq Financial Products Services Inc.

But haven't we seen all of this before? Investors are pouring money into companies that have great stories to tell, but whose earnings are tiny or nonexistent. The result: Along with biotech's sudden rise in the Nasdaq, the Amex biotech index has climbed more than 200% during the past three years. And with Amgen Inc.'s \$16 billion purchase of Immunex Corp. on Dec. 17, following several other highly publicized biotech deals (page 50), the industry seems tempting.

Sounds an awful lot like the Internet bubble all over again. And in one sense, it is: The high market capitalization of many of these stocks suggests that investors are paying a lot in anticipation of future earnings that may never materialize. It costs tens of millions of dollars and can take five to 15 years to get a drug from the test tube to the clinic—and many drugs simply don't make it.

How high are the valuations? By any traditional standards, they appear to be hugely overinflated—if only be-



cause the lack of earnings makes applying traditional standards impossible. But even looking at revenues alone, that remains true. One of the stocks added to the Nasdaq 100, ImClone Systems Inc., has a market capitalization about 120 times its revenues. That's about where Amazon was in early 2000, near the peak of the Internet boom. Pharmaceutical market leader Merck, in comparison, has a market capitalization of less than three times its revenues.

In several ways, however, this boom is different. The industry is more mature than it was a decade ago, when it last rose and fell. New alliances, new products, and new financing should combine to produce lasting growth in

this once-turbulent field. There are some 300 biotech products in Phase III testing, the final stage of human experimentation before seeking Food & Drug Administration approval. The FDA issued 32 approvals for biotech drugs in 2000, a 45% increase over 1999. Sales of biotech products

NEW PHASE

Valuations are high, but new alliances and new products should bring lasting growth

rose from \$16.1 billion in 1999 to \$18.1 billion in 2000, an increase of 12%. And there were 22 profitable biotechs in 1999, up from 17 in 1997. “Everything is going in the right direction,” says

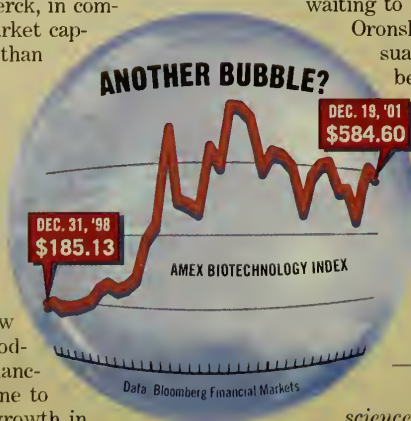
Arnold L. Oronsky, general partner at InterWest Partners, a venture-capital firm in Menlo Park, Calif.

Furthermore, unlike many Internet companies, the biotech companies are targeting clear and existing markets. Many Internet companies devised products without knowing whether there were markets for them. Others, such as Yahoo!, aimed for ad revenues that proved far smaller than hoped. Biotech companies don't have that problem: A drug for arthritis or cancer, say, has a huge market. If their drugs work, the biotechs will make money.

Excitement in biotech will likely get another boost when the climate for initial public offerings improves. There are 50-100 biotech companies waiting to go public, says

Oronsky. That's where casual investors should be especially careful.

Some of today's most promising biotechs will undoubtedly fall short of the hype. Unfortunately, that's one way this boom won't differ much from the last.



Raeburn covers science from New York.



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COMMUNICATION WITHOUT BOUNDARIES

FINANCE

HAS WAMU BEEN BUYING TROUBLE?

Washington Mutual is facing a pair of class actions

When Helen Wisner got a house call from a Washington Mutual Inc. representative last spring, she opened the door. After all, the 89-year-old had banked with Home Savings of America, bought by WaMu in 1998, for decades. An hour later, a financial adviser from WM Financial Services Inc., WaMu's brokerage arm, left with over \$3000 in commissions, she claims. The representative had allegedly moved \$70,000 in certificates of deposit—insured by the Federal Deposit Insurance Corp.—from Ms. Wisner's account into riskier bond funds.

Wisner says she thought she was buying a no-risk investment from her bank. She isn't alone, according to a suit filed on Dec. 19. The suit alleges that WM Financial agents routinely prey on elderly WaMu customers, using records from WaMu's banking unit to locate customers with big balances. WaMu says it has not yet seen the suit, so it cannot comment.

Such allegations are surprising. On Dec. 5, CEO Kerry Killinger was lauded as "Banker of the Year" by industry trade paper *American Banker*. And analysts have gone out of their way to praise the bank's customer-friendly attitude and fast-growing revenue stream.

So which view of WaMu is correct? It's clear the company is enjoying phenomenal growth. Nevertheless, a string of disturbing allegations has cropped up recently. As the budding financial services giant has done a flurry of deals to acquire rivals throughout the country, including some with troubled business practices, it appears that problems at those units haven't always been resolved. The company says it has successfully managed its integration challenges.

Buying businesses to acquire customers has been a core strategy for WaMu. Since 1990, it has done more than 20 acquisitions, expanding into everything from lending to insurance to financial advice. In doing so, Killinger has transformed the tiny Seattle thrift into the nation's seventh-largest bank, the



CEO KILLINGER

The budding financial-services giant has done a flurry of deals to acquire rivals, including some with troubled business practices

No. 1 home lender, and a manager of over 200,000 investment accounts. During that time, assets grew 25-fold, to \$225 billion.

But with the expansion, it seems to have picked up some problems. Allegations like Wisner's mirror ones from a previous lawsuit filed against Great Western, which WaMu later bought in 1997. Although WaMu said it had stamped out such practices against elderly clients, Michael Swick, an attorney from Milberg Weiss Bershad Hynes & Lerach, which is bringing the suit, believes they have been revived.

The complaints are not limited to the company's investment arm. Since WaMu bought Houston-based Bank United this year, Jenelle Welling, a Green Fauth & Jigarjian partner, alleges the bank has continued its practice of over-charging late fees. Her firm expects to file a na-

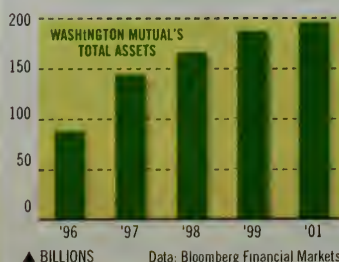
tional class action this month. WaMu spokesman Kevin Horn says the accusations are "inherited issues" that "are not in line with current business practices." Some analysts agree. Lawsuits may be just "one of the pitfalls of being an aggressive acquirer," says Bradley Ball, a financial services analyst with Prudential Securities. Having bought up numerous thrifts in the aftermath of the Savings & Loan crisis, he says WaMu ended up with purchases that "came with some baggage."

But other glitches have arisen with more recent buys, too. This fall, thousands of former customers of PNC Mortgage, which was bought by WaMu in February, were surprised to receive threatening letters from their local taxman. Most homeowners' property taxes are paid from an escrow account maintained by their mortgage lender. But when WaMu bought PNC, it neglected to fill in tax information for some 55,000 customers, so their taxes went unpaid.

According to Horn, the bank has straightened out all but 350 accounts. It has paid back taxes and is refunding customers for penalties. "As a company grows, problems will arise," he says. "What's important is how they solve the problem." True enough. But such recurring problems won't help Washington Mutual's sterling reputation.

By Heather Timmons in New York

GROWING HEFT



EDITED BY JOHN PROTOS

CITIGROUP'S LONG DIEU TO TRAVELERS

FINANCIAL-SERVICES FIRMS spent the past few years consolidating to create broker, banking, and insurance giants. Will they spend the next few spinning unwanted pieces off? That's the view of some after Citigroup said on Dec. 19 that it would shed 20% of its insurance arm, Travelers Property and Casualty Group, in an initial public offering in the first quarter of 2002. Citigroup expected to make \$4 billion to \$5 billion from the sale, which was spurred by the unit's lower-than-desired returns. Citigroup took a 10¢ hit to earnings in the third quarter because of losses related to September 11. "Property and casualty will be a consolidating industry, but we at Citigroup do not want a greater percentage of our volume in the business," said chairman and CEO Sanford J. Weill. Citigroup said it will spin off the remainder of the

unit to shareholders at the end of 2002.

FEDEX DELIVERS —FOR NOW

CALL IT A VERY SPECIAL delivery. FedEx said on Dec. 19 that earnings soared 26% during its second fiscal quarter. Net income was \$245 million, compared with \$194 million the year before. Earnings included \$116 million from the U.S. bailout of the airline industry. Also helping earnings was a 10% decline in fuel expenses. But it may not last: FedEx management warned that next quarter's earnings may be lower than expected.

THERE'S LIFE AFTER MERRILL

STANLEY O'NEAL'S FORMER rivals for the president's job at Merrill Lynch have moved on in style. On Dec. 19, Credit Suisse Group announced that Merrill's former head of asset-management, Jeffrey Peek, will join John Mack in his mission to remake CSFB into one of Wall Street's most prestigious investment banks. Peek will now oversee CSFB's asset management, securities clearing, and high-net-worth individual brokerage businesses as its vice-chairman. And Winthrop Smith Jr., former chairman of Merrill Lynch International, will continue considering his options while skiing at Sugarbush Resort in Warren, Vt. He was part of a group that purchased the resort in October.

NO HAPPY NEW YEAR FOR MOTOROLA

DISAPPOINTING WALL STREET is becoming a familiar activity for Motorola. After posting losses in every quarter this year, the tech giant said

HEADLINER: CHARLES WATSON

PUTTING PEP IN DYNEGY'S STEP

ENRON ANGST IS SWEEPING other energy companies. In the wake of the recent collapse at the energy trading powerhouse, the disease is hitting hard at Dynegy, Enron's one-time suitor. With Dynegy's stock plunging and its credit rating downgraded on Dec. 14, CEO Charles Watson has promised investors and rating agencies some strong medicine: a \$1.25 billion restructuring plan designed to strengthen his balance sheet and improve liquidity.

Watson's program, similar to those at El Paso Corp. and Williams Cos.

Inc., includes selling "nonstrategic" assets, slashing capital spending, and issuing \$500 million worth of new stock next year.



It's a "prudent step," says Ron Barone, an analyst at Standard & Poor's. "People are no longer going to underestimate the market psychology." Indeed, when investors and trading partners lost faith in highly leveraged Enron and its convoluted finances, the company spiraled into bankruptcy. Now Watson, once crowing about his \$9 billion bid for Enron, is scrambling to satisfy that same unforgiving market.

Wendy Zellner

on Dec. 18 that the start of 2002 looked even grimmer than anticipated. The company will suffer another loss, thanks to a continuing sales slump. As a result, it will lay off 9,400 workers—bringing the total to 43,000 since August, 2000. CEO Christopher Galvin argues the new round of cuts will save \$862 million and make Motorola a "more flexible and profitable company." But impatient investors sent the stock tumbling 5%, to close Dec. 19 at \$15.76. They want Galvin "to develop a well-thought-out strategic plan on how to resume growth," says Deutsche Banc Alex. Brown analyst Brian Modoff.

GE PULLS OUT THE AX AGAIN

GE IS RESTRUCTURING ITS finance unit and laying off 3,000 people worldwide. While that's less than 1% of

GE's workforce, Chief Executive Jeff Immelt says the changes at GE Capital, which makes up some 40% of the company's total earnings of \$13 billion, will help the unit's earnings grow more than 15% next year. That's vital if Immelt is to deliver the 17% to 18% earnings growth—up to \$1.67 a share—he projects for GE in 2002. Of course, it helps that he's coming off a lower base, with only 11% growth projected for 2001.

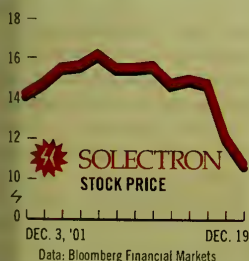
ET CETERA...

- Toshiba is pulling out of low-end memory chips by selling its U.S. plant to Micron.
- Carnival is making a hostile bid for smaller rival P&O Princess Cruises.
- Handheld computer maker Palm reported a second-quarter loss of \$25.2 million.
- Hawaii's two main carriers, Hawaiian Airlines and Aloha Air Group, agreed to merge.

CLOSING BELL

SHORT CIRCUIT

A \$52.5 million loss for the quarter ended Nov. 30 at Solecron, the world's biggest electronics-manufacturing services company, helped push its shares down 32%, to \$11, on Dec. 11. The loss wasn't the only thing that rattled Wall Street. Standard & Poor's bumped Solecron's debt down to junk status.



AFGHANISTAN

REBUILDING FROM SCRATCH

Can Afghanistan's untested leaders remake a country in shambles?

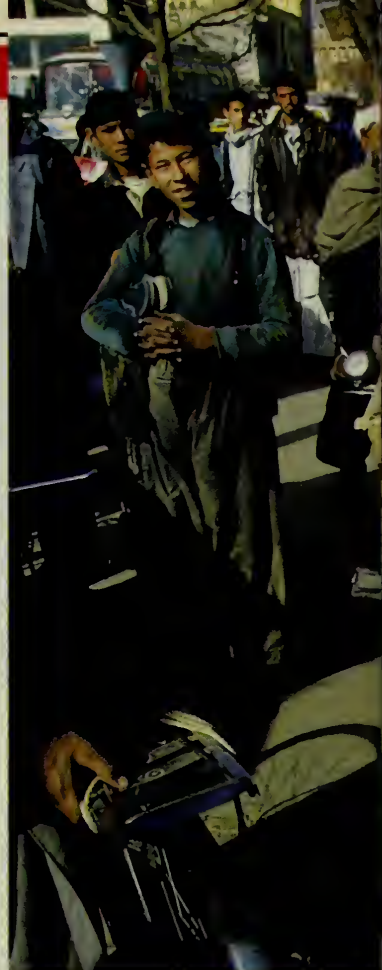
Muhammad Ullah knows firsthand the vagaries of doing business in Afghanistan. Ullah runs a plastic shoe factory on the outskirts of Kabul. Every few hours the capital's power grid falters, bringing production at Ullah's Nawai Sadaqat Plastic plant to a halt. Each time that happens, Ullah wastes \$33 in spoiled materials. That may not sound like much, but in Afghanistan it can mean the difference between making a profit and losing money. Now, with the Taliban gone, the roads are no longer as secure and Ullah is finding it harder to get his shoes, sandals, and slippers to customers in and around Kabul. Says the 31-year-old entrepreneur: "I want the government to take better care of industry."

It's a forlorn hope. For while Ullah and his neighbors at the Soviet-era Parkhai Sanati industrial estate show remarkable entrepreneurial spirit, theirs is a seriously sick country. More than two decades of war have destroyed much of Afghanistan's infrastructure: its roads, bridges, power plants, hospitals, and water mains. Money-changers have replaced bankers. The few phone lines usually ring busy. In Kabul, residents pump their own water, light their homes with flashlights, and warm themselves with cheap

electric space heaters made in China.

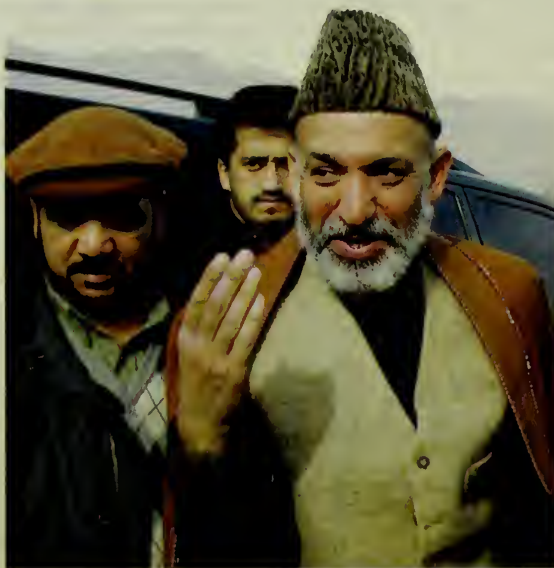
Moreover, despite a great deal of optimistic talk about bringing Afghanistan into the 21st century, few sober-minded people believe such a feat possible any time soon. Even ministers of the new interim government scheduled to take power on Dec. 22 acknowledge that rebuilding the economy is a daunting job. The economic and educational policies of the theocratic Taliban regime didn't help. "We had textile factories run by priests who didn't know two plus two," says Abdul Sami Wali, an adviser to Finance Minister Hedayat Amin-Arsalan. "It will take at least 15 years to rebuild our economy."

With few ideas of their own, the nation's new leaders are dependent on the good offices of the international community—its billions in aid, its security forces, its legions of experts, and not least, its commitment to stick around. The new administration was cobbled together so quickly that it has yet to formulate coherent policy. While the new



President, 47-year-old Hamid Karzai, was a deputy foreign minister in the Soviet-backed regime of the 1980s, he never considered himself a candidate for the top job, according to a prominent Afghan exile in India. Moreover, the leaders were picked for their ethnicity, not their ability to govern. "Of the government," says Masood Khalili, a senior adviser to the Northern Alliance, "only two may know administration. They're all politically oriented." Karzai's main task will be to keep the coalition stable for six months—until a *loya jirga*, or tribal council, meets to either reconfirm his regime or install a new one pending elections scheduled for 2004.

Afghanistan's untested leaders are faced with the prospect of rebuilding key national institutions from scratch. Consider the Central Bank of Afghanistan. What little reserves it had—probably only a few million dollars—were long ago spirited away by the Taliban. Sitting in his dimly lit Kabul office, the central bank president, Said Allah Hashimi, acknowledges the



PEACEKEEPER?

Karzai heads a coalition picked for its ethnicity



BACK TO BUSINESS

The resourceful Afghans are seizing new ways to become entrepreneurs

landlocked nation has been a trading crossroads for Central Asia since medieval times—and that hasn't changed. Each year, millions of dollars worth of smuggled cars, electronics, and textiles move through the country. Some say legitimizing and taxing the trade would provide the government with a steady revenue stream. But such a plan would require neighboring nations to lower tariffs on foreign goods—and that won't be so easy.

Before anyone can seriously contemplate rebuilding the economy, millions of Afghans must be fed and housed before the full onset of winter. The first step is securing the roads so aid can get through, especially Route A1, along which goods travel to and from Pakistan, Turkmenistan, and Iran. British forces, familiar with humanitarian missions, are expected to lead the

as no idea how many bits of the local currency, the afghani, are in circulation. As it is, there are two versions of the afghani: one issued by the Northern Alliance and printed in Russia, the other put out by the faction of Uzbeki warlord Rashid Dostum. Along with the afghani, Kabulis use U.S. dollars and Pakistani rupees to buy groceries.

Over at the Commerce Ministry, the new minister, Mustafa Kazimi, has some broad ideas—very broad. He favors free trade and giving firms from donor nations the first crack at plum investments. Asked what might stimulate some economic

activity, he points to a long-discussed pipeline that would cross Afghanistan, bringing natural gas from Turkmenistan to Pakistan's coast and taxes to Kabul. With bandits infesting the countryside, the project is little more than a dream. All of this is not to say the situation

TALL ORDER

THE FIRST STEPS

- Feed millions of displaced Afghans
- Secure highways and border crossings
- Rebuild airports, power grids, and other infrastructure in Kabul
- Restore depleted foreign reserves
- Establish financial system so aid can be properly disbursed
- Pay civil service back salaries

Data: BusinessWeek

is hopeless. As Ullah, the footwear maker, demonstrates, the Afghans are remarkably resourceful. Take Sakhi Mohammad, proprietor of the Kabul Supermarket on Flower Street, one of the capital's few undamaged commercial thoroughfares. The moment he learned the capital was about to fill up with U.N. officials and aid workers, he managed to get his hands on the goods foreigners crave: King Edward cigars, Toblerone chocolate bars, Carr's crackers, Camembert cheese. Now he claims to ring up \$350 in daily sales, five times what he did during Taliban times. "In the past, I didn't

buy anything pricey," says Mohammad. "No one bought it."

To be sure, every aid mission is at first a gold rush that eventually fades away. But Mohammad and his ilk provide clues to what Afghanistan's economy could look like in a few years. The

effort. British troops have been charged with helping maintain law and order in Kabul. This is crucial; aid workers are predicting renewed fighting in the capital.

Establishing a financial system is another crucial first step. In the coming months and years, Afghanistan will be flooded with as much as \$10 billion in aid; all that money needs to get to the right people and places. Another priority: rebuilding the agricultural sector, which employs much of the population and has been hammered by drought. Then, perhaps, the government can look for foreign investors to develop an inactive coal mine and six inactive gas fields, among other coal, gas, and mineral deposits. "If we could export our natural resources," says acting mines and industry minister Akram Ghiasi, "we could become a rich country."

Much depends on the international community. "Peace will pave the way for Afghanistan," says Commerce Minister Kazimi. "But we know peace is not enough." Indeed, if Afghanistan is to avoid reverting to its role as terror factory, it will need to rebuild—and fast.

By Michael Shari in Kabul, with Manjeet Kripalani in New Delhi and Frederik Balfour in Islamabad

COMMENTARY

By John Rossant

WHY A FEW ENRONS WOULD DO EUROPE GOOD

The most terrifying aspect of the collapse of Enron Corp. was its swiftness. Just three months ago, this icon of American economic modernity was the country's seventh-largest corporation by revenues. By Dec. 2, close to \$60 billion in market capitalization had gone up in smoke, and Enron lawyers were scurrying to file for bankruptcy. One week later, Citicorp and UBS Warburg put offers on the table to acquire pieces of the once-mighty Enron trading empire. In the wake of all this, 4,500 Enron employees have lost their jobs, and thousands more have seen their savings and pensions evaporate. This truly was warp-speed corporate destruction: merciless, devastating, and final.

Yet Enron's fall is a reminder of just why the American economy has been performing so much better than its European rivals over the past two decades—and why it will probably continue to do so despite the pain of the current recession. The speed at which Enron crashed is almost a textbook example of Austrian-born economist Joseph A. Schumpeter's celebrated description of “creative destruction” as the heart of vibrant capitalism. An industrial failure, wrote Schumpeter in a famous passage from the book *Capitalism, Socialism and Democracy*, “incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one.”

Compare and contrast that idea with the state of Europe's industrial undead. During the same November week that Enron was fessing up to what Chairman Kenneth L. Lay called some “very bad investments,” French computer-services company Bull was cashing a \$90 million check in emergency government aid. This was only the most recent handout from the state, which indirectly controls some 32% of the business. The

government has poured almost \$7 billion into Bull since the 1960s in an attempt to make France a player in the computer industry. Yet Bull has enjoyed exactly one year of profitability since 1988. This corporate vampire should have gotten a stake through the heart years ago.

It's the same story at France's Moulinex, the luckless manufacturer of kitchen appliances. The company has been through a series of government-sponsored industrial reorganizations since the mid-1980s. Some of

get a better deal on layoff packages. “I am somewhat detained, but it's not a real drama,” was the message the nabbed mediator managed to phone in to the press.

Even the U.S. occasionally indulges in the preservation of historic industries: Current efforts to protect what's left of Big Steel smack of this. Europeans are the real masters, though. In Germany, Chancellor Gerhard Schröder assembled a \$130 million package of state aid in late 1999 to keep afloat the huge Frankfurt construction group Philipp Holzmann. The move has essentially sabotaged Germany's construction industry, which is plagued by massive overcapacity. Former blue chip Holzmann should have been allowed to die, freeing up resources to flow into more productive areas of Germany's economy.

Some executives hope that hard times will finally force Europe's policymakers to renounce their urge to meddle. “Things will change because there is no other way to do it,” predicts Leo Apotheker, board member in charge

of Europe, the Middle East, and Africa at German software giant SAP, one of the few truly new technology powerhouses in Europe. “European governments will run out of money otherwise.” There's counterpressure, too: Already, national administrations are finding it hard to get Brussels' European Commission to sign off on state aid packages for distressed companies. And current Competition Commissioner Mario Monti is making a crusade out of fighting state aid. But governments keep trying. Every time they succeed, Europe's economy loses another chance for renewal.

Rossant covers economics and politics from Paris.

By sustaining brain-dead companies, the Continent only hurts itself



the remaining 21,000 employees are adopting unusual methods to keep their jobs as Moulinex nears collapse. At about the same time that freshly laid-off Enron workers were scanning the help-wanted ads, Moulinex employees at a microwave factory in northern France threatened to detonate homemade bombs to destroy what was left of the plant. (Most of it had been set afire by workers the day before.) Union officials even kidnapped the government-appointed mediator to try and



UROPE

ONE CURRENCY— BUT 15 ECONOMIES

clashing regulations make cross-border business difficult

Europeans will celebrate the birth of a new era when they crack open the Champagne on Jan. 1. As 2002 dawns, 12 European Union countries will introduce euro coins and notes. By the end of February, 300 million people from the Canary Islands to the Finnish tundra will use the same money. Economic and monetary union—10 controversial years in the making—will be officially complete.

The physical euro will bring many benefits, including greater price transparency from one country to another and more cross-border trade and mergers. But the hard part of integration is still unfinished: forging 15 national economies—including the three EU members yet to take up the euro—into a single economy. With the mammoth currency project out of the way, executives say they plan to pressure national and European-level politicians to eliminate the overt and tacit barriers that still prevent the EU from being a true, single market. "Regulation and supervision, the handling of cross-border payments, how governments award contracts—all need reforming," says Richard Needham, vice-chairman of Dyson Appliances Ltd., the British white-goods manufacturer.

Unifying the financial system is a priority. When large banks in one country try to make acquisitions in another, national regulators, in flagrant breach of EU rules, quietly veto them. Securities

market regulations still are not harmonized. With the notable exception of Euronest, the merged Belgian, French, and Dutch bourses, most stock markets are national affairs. A German company buying or floating shares in Milan and London, for example, encounters a snarl of rules. "All this adds to industry's costs and makes it less efficient," says Edzard Reuter, former chief executive of Germany's DaimlerChrysler.

Not that regulators and politicians deserve all the blame. Bankers often lobby vigorously in Brussels against harmonization when their local advantages are at stake. That's why cross-border payments in the euro zone take longer—and cost as much as 10 times more—than domestic transactions. The Euro-

pean Parliament will soon debate a law that would prevent banks from discriminating between domestic and cross-border transfers, but the banking lobby is expected to kill it.

There are also myriad differences in standards and regulations from country to country. After years of trying, European nations have yet to agree on what shape an electrical plug should be. Small wonder, then, that there's still no

single market for electric power. France has resisted opening its market, while state-owned Electricité de France aggressively expands abroad. Governments retain "golden shares" in privatized utilities to keep foreigners from buying them.

Business leaders also chafe at the variations in accounting standards, tax regimes, and social security laws. "The fact that consumers pay such different taxes to purchase a car, in addition to value-added tax, is a major issue," says Louis Schweitzer, CEO of Renault, the French carmaker. Consumers in high-tax areas increasingly shun local dealers for those in countries that offer a better deal.

Moving people around is no less complicated. Elie Vannier, group managing director of Paris eyewear retailer Grandvision, who recently sent French employees to Italy, says the red tape is "so complicated that you wonder if it's worth the hassle."

European Commission officials calculate that without such impediments, the euro-zone economy could grow by an additional 1% each year. Yet more often than not, efforts to knit together national economies fall victim to obstructionism. In 2001, German intransigence scuttled a proposal for a common law on mergers and acquisitions that took 12 years to bring to a vote in the European Parliament. The EC's Financial Services Action Plan, unveiled in 1999, has made little headway.

Given its record, it's astounding that Europe managed to create a single currency in just 10 years. That accomplishment, at least, raises hopes for more harmonization. Who knows? By the time today's children are old, there may be one plug that works in every electrical outlet in Europe.

By David Fairlamb,
with Christine Tierney in
Frankfurt and bureau
reports

EUROPE'S UNFINISHED BUSINESS

WHAT THE 12 EURO-ZONE COUNTRIES HAVE

- A single currency
- Unfettered movement of capital
- Tariff-free trade between member states
- Free movement of labor

WHAT THEY DON'T HAVE

- Common economic regulation
- Coordinated economic policies
- Cross-border trade free of nontariff barriers

Data: BusinessWeek

FRANCE

FOR CAP GEMINI, THE WRONG MATE AT THE WRONG TIME?

Its merger with Ernst & Young's consultancy is sinking profits

It was billed as one of the great transatlantic mergers of the new millennium. In May of last year, Paris technology-services company Cap Gemini laid down \$11 billion for the consulting arm of Ernst & Young, propelling itself overnight into the ranks of the top five global consulting firms. Analysts hailed the deal as a perfect match of European high-tech expertise and an American marquee name.

As it turned out, the honeymoon was brief. Profits at Cap Gemini Ernst & Young are set to fall by more than half this year, to \$154 million on sales of \$8.1 billion, as the firm's clients slash tech spending in the face of a global economic slowdown. What's more, the Ernst & Young acquisition increased Cap Gemini's exposure to the U.S. market, where the tech downturn has been

sharper than in Europe. "The timing was impeccably wrong," says Richard Holway of British information-technology research group Ovum Holway. To compensate for lost business, Cap Gemini has slashed 9% of its 60,000-strong workforce. Still, its shares have shed two-thirds of their value since the merger.

Now it's up to a newly appointed CEO to tailor Cap Gemini's ambitions to fit the industry's new realities. On Jan. 1, former Chief Operating Officer Paul Hermelin, a 49-year-old Frenchman, takes the helm. He replaces Geoff Unwin, a 59-year-old Briton who is taking a long-planned retirement after 11 years at the company. Hermelin's appointment was announced at a Dec. 12 press conference, at which the company also disclosed it was taking a full-year \$180 million restructuring charge to cover a new round of 2,500 layoffs and other cost-saving measures. "We've tried to be too many things. It's time to streamline," says Hermelin.

An eight-year Cap Gemini veteran, Hermelin is seen as a good choice to lead the company through a restructur-

ing. "He has a strong focus on operations and costs," says Ariel Bauer of Merrill Lynch Global Securities. Cost-cutting is essential now that demand for Cap Gemini's core business—helping clients install big, complex IT systems—is plummeting. More clients are trying to control costs with outsourcing deals, in which they hire outsiders to run their IT systems, from inventory control to customer-relations management. Although outsourcing is a relatively low-margin business, rivals such as IBM, EDS, and Accenture have posted healthy results this year by concentrating on such deals. But Cap Gemini has been a laggard: Even on its home turf

in Europe, it did less than \$1 billion in outsourcing work last year, compared with almost \$4 billion by industry leader IBM.

Hermelin says he is pushing to boost outsourcing and expects to account for 30% of all business in three years, up from 16% in 2000. In a bid to lure cost-conscious clients, Cap Gemini is setting up an affiliate that will rent out engineers at daily rates. That's

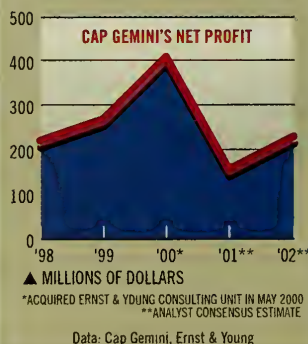
risky move, since long-term consulting relationships yield the fattest profits.

Indeed, with scant demand for the management-consulting services that were Ernst & Young's strong suit, operating margins have shrunk from more than 10% to only 5%. The layoffs will help. But Cap Gemini still has to prove that the marriage made sense in the first place. Hermelin contends that when the economy rebounds, big corporate clients will again seek advice from full-service global group. Others, however, argue that the merger was a mistake. "There's just no need for primadonnas in consultancies developing fabulous new projects," says Holway.

So where does that leave the ex-employees of Ernst & Young? Management acknowledges they account for a disproportionate share of the layoffs, although it won't give precise figures. Others have left voluntarily. "They are dismantling the core consulting business that Ernst & Young built up," says one. "I just didn't see a place for myself there." Just another reminder that a merger made in a boardroom isn't necessarily a marriage made in heaven.

By Carol Matlack in Paris

SHORT HONEYMOON



TAG TEAM

Unwin and his successor, Hermelin



COMMENTARY

By Brian Bremner

WEAKENING THE YEN WON'T MAKE JAPAN STRONG

It becomes clearer by the day that Japanese policymakers will try anything short of real reform to get their country out of its 10-year slump. The latest stratagem: Trash the yen, which markets had already pushed as low as 128 to the dollar on Dec. 18, and use cheap exports to stoke the economy. This shopworn rescue tactic has, in the past, earned Japan no end of opprobrium from its trading partners, who resent competing with cheap Japanese goods while Tokyo does nothing to boost domestic demand. But risking an international firestorm is not the worst part of a weak-yen strategy. The worst thing about the plan is that it won't work.

The latest variation of this currency game was a scheme to get the Bank of Japan to weaken the currency by printing yen and using the new money to buy U.S. Treasuries. As expected, BOJ Governor Masaru Hayami, historically a strong-yen advocate, nixed the idea after a policy-board meeting Dec. 18 and 19. In any case, the pressure to weaken the yen will continue, as politicians, hard-pressed exporters, Finance Ministry officials, and even some BOJ insiders continue to push the issue.

The revival of the weak-yen debate—the currency is now at its lowest point since 1998—shows how desperate Prime Minister Junichiro Koizumi has become. Though he hasn't said he favors a weaker currency, his options are narrowing. Bureaucrats and Liberal Democratic Party hacks have smothered his brave plans for recreating Japan's economy by instituting fiscal austerity, closing state-run corporations, and cleaning up the banks' debt overload. Other traditional ploys to kick-start the economy are losing power. After a series of credit-rating downgrades, the government can't issue debt to bankroll more pork-barrel projects. Interest rates are already near zero. That leaves the yen and the fantasy of an export-led recovery.

Truth is, a cheap yen won't help much. That's because exports repre-

sent only about 10% of the Japanese economy. More important, devaluation is a strategy for a Japan that no longer exists. Ten years ago, its manufacturers made most of their goods at home. Today, yen costs are a much smaller part of production because such giants as NEC, Honda, and Toyota—like multinationals everywhere—buy raw materials and parts and manufacture around the world. According to Tetsufumi Yamakawa, chief economist at Goldman, Sachs & Co., 15% of Japanese

across Asia. If the yen gets much closer to 147 to the dollar, its low point during the 1998 emerging-markets crisis, both China and South Korea have made it clear they will be very unhappy. South Korean Deputy Prime Minister Jin Nyum has warned that a Japanese devaluation strategy risks "sparking a race of depreciation in the region." Chinese Finance Minister Xiang Huaicheng recently said China wouldn't devalue

the yuan to boost exports.

But Beijing does consider the 130 yen to the dollar level as an important psychological threshold, beyond which the risk of currency turmoil increases.

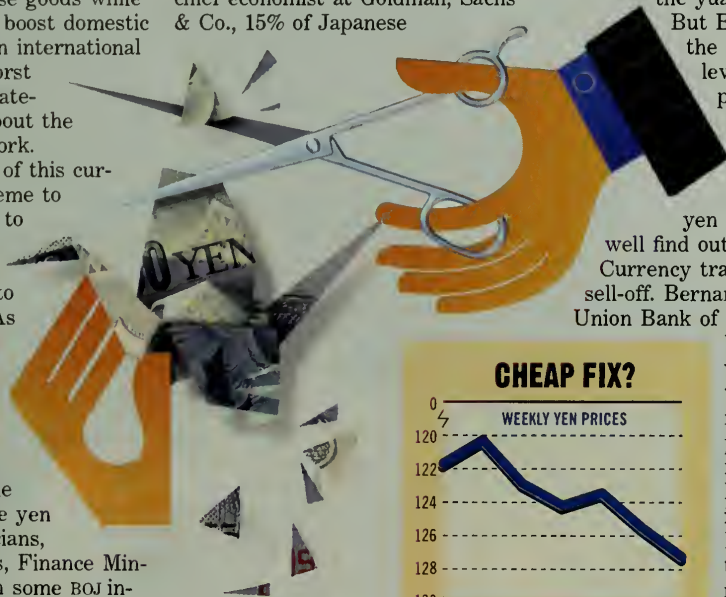
How low can the yen go? The world may well find out in the coming weeks. Currency traders already smell a sell-off. Bernard Tsui, a trader with Union Bank of California, says he is

booking a lot of forward currency contracts in the 130-yen range now, and "I expect 135 or so in the first quarter." The Bush Administration isn't helping matters. It's preoccupied by the war against terrorism and torn by internal conflicts over its Japan policy.

White House economic adviser Larry Lindsey, who supported the Treasuries purchase scheme, has indicated that he doesn't object to a weaker yen. Treasury Secretary Paul H. O'Neill says currency fixes can't substitute for the tough steps Japan has to take to clean up its economic mess.

O'Neill is right. Obviously, a superstrong yen isn't in Japan's interest, but orchestrating a plunge in value is daft. A policy of damaging the economies of South Korea, Taiwan, and Singapore is bound to backfire on Japan, which exports 35% of its goods to the region. Japan and the rest of Asia need a stable yen, not a debased one.

With Rich Miller in Washington and Moon Ihwan in Seoul



CHEAP FIX?



manufactured goods were produced offshore in 2000, vs.

6.4% in 1990. In fact, a cheaper yen could hurt domestic producers by driving up the cost of imported parts and oil.

The other hope of the weak-yen lobby is that by raising the cost of imports, policymakers will stop Japan's deflationary spiral. Again, the logic is flawed. A yen devaluation might raise import prices, but not enough to stop the 1%-a-year fall in consumer prices. HSBC Securities Inc. economist Peter Morgan figures a 10% depreciation in the yen adds just 0.1% to the consumer price index. "The yen would have to fall to well below 200 [to the dollar] to raise the CPI by one percentage point," he says.

Worse, in exchange for minimal gains, Japan risks exporting chaos

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WHERE TO INVEST

The new rules of risk

Introduction Wall Street will see gains in 2002, but they will come in fits and starts. Our Investment Outlook provides a strategy for weighing a broad array of assets—and managing risks that were unimaginable just a year ago **64**

The Framework The recession will end, but hold your applause: The recovery will be modest and leisurely. And the Feds will have to make tough choices about where to pitch interest rates and how to cut spending further **66**

Strategies for Stocks & Bonds With risk taking on a new dimension, a diversified plan of attack can keep your money working. From long shots to REITs to foreign stocks, here's a road map to the possibilities **76**

The Investment Spectrum Mutual funds are coming off one of their worst years ever. Real estate and gold funds did better than health-care funds. Meanwhile, in the art world, America became cool again **110**

The Investment Scoreboard With its 900 companies spanning 24 industries, *BusinessWeek's* Scoreboard shows where the values are, where earnings are going, and which tech stocks are poised for a rebound **116**

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Time to Get Back In the Game—Cautiously

Our Investment Outlook forecast for 2002 is optimistic, if not exuberant

BY MIKE McNAMEE

So you're thinking the latest mini-bull market will lift you right out of the unhappy memories of 2001 and back to those up-up-and-away days of the booming 1990s? Well, you had better think again. We're in a new world of risk, with radically altered markets—and investors will forget the lessons of 2000 and 2001 only at their peril. What lessons? That markets can go down just as fast as they go up. That concentrating on the latest winners will concentrate your losses, too. That New Economy recessions can be just as harrowing as the old ones. And, most hauntingly, that the world is still a dangerous

place, and Americans' best-laid plans can be wrenched apart by forces far outside our borders.

Confronting and controlling those risks is the theme of *BusinessWeek's* Investment Outlook for 2002. Our forecasts are optimistic—but cautiously so. Wall Street is looking for an 8%-to-10% gain in the broad Standard & Poor's 500-stock index during 2002, but those gains will come in fits and starts (page 76). Take the 16% gain in the S&P from the lows of September: Wall Street is bidding as if it expects a robust recovery, even as the Street's own economists say the economy will grow only 2.4% in 2002 (page 66). Even with bonds, you're going to have to go further out on the risk curve—away from Treasuries and AAA corporates to higher-yielding junk bonds and emerging-country debt—to get decent returns (page 78).

To protect yourself, branch out. While growth stocks have been in the tank, dividend-paying stocks have shown that they're not just for Grandma (page 88). Real-estate investment trusts appear poised for a third strong year (page 92). Specialty mutual funds—playing the merger

game, dabbling in commodities, or picking losing stocks and selling them short—can broaden your portfolio and hedge your bets (page 98).

To control risks, you'll need to set targets—and discipline yourself to follow them. Jay Sekel

sky, lead equity manager at Mosaic Investors Fund, looks for “growth at reasonable risk.” He won't buy a stock unless the gain he expects when it hits his target price is at least three times the worst loss he would fear. Sekelsky's second rule, especially apt in the wake of Enron Corp.'s meltdown: “If I can't understand the financial report, don't buy it.”

The battering of the past two years has made Ameri

cans more realistic about stocks: In our *BusinessWeek*/Harris poll, 54% of investors say that stocks will pay just single-digit returns in the long run (page 86). But “faith in the market is still strong—the equity culture is not going away,” says Jeremy J. Siegel, professor of finance at the Wharton School. Americans realize that investing is their key to future wealth—and coping with a new world of risk is the key to successful investing.

Battered

Investors have grown more realistic about their targets.

Controlling risks in this harsh new terrain takes discipline

BusinessWeek online

For a special package of online features accompanying the Investment Outlook, go to the Dec. 31 issue online at www.businessweek.com.



This Recovery Will Be a Slog

Moderate growth will follow a mild recession

BY JAMES C. COOPER
AND
KATHLEEN MADIGAN

The year ahead will be a time for healing. The pain of September 11 wounded America's psyche—and its economy. But in the coming months, the forces of recovery that are now falling into place will lift the economy out of its 10th recession since World War II.

The turnaround will go a long way toward raising the spirits of both households and businesses.

That's the general expectation of the 59 economists in *BusinessWeek's* 2002 outlook survey. The consensus view is that this recession will end around the first quarter of 2002, and for the year, real gross domestic product will grow by 2.5%—a big gain from the less than 1% rise expected for 2001.

But hold the applause. The recovery will be gradual and perhaps disappointing to some investors because it will follow an atypical downturn. The chief anomaly is that consumer spending has not tanked the way it usually does. "The recession differs considerably from those in the past in that it is a business-led recession, generated mainly by the consequences of a boom-bust cycle in business investment and the accompanying decline in equity prices," says William C. Dudley at Goldman, Sachs & Co. Consequently, the intense squeeze on profits has led to aggressive cost-cutting that is fueling a wave of layoffs. "The current business attitude in virtually all industries is, if any spending is nonessential, cut it," says Donald Straszheim at Straszheim Global Advisors in Los Angeles.

The good news is that the recession that began in March will likely be one of the mildest in the postwar era. By the second half, the forecasters expect real GDP growth to pick up. And by yearend, most economists look for the Federal Reserve to begin lifting interest rates, but not enough to shift monetary policy from its very accommodative mode to a more neutral stance.

Don't expect a return to the heady days of 4% to 5% real growth, soaring profits, and 30% gains in stock prices. Those days are gone. Instead, look for economic activity that is governed by fundamental relationships. Consumer spending will grow more closely with household income. Capital spending will be guided by profit and cash flow, and stock prices will rise in line with more sensible expectations for risk and reward.

The fearless forecasters at *BusinessWeek* agree with the survey pattern but are a notch less optimistic about growth, given that the recovery faces some stiff headwinds. First, excess production capacity and inventories in the tech sector will work against a rebound in capital spending. Second, consumers will play less than their typical starring role in the upturn, as housing and auto sales have remained strong and thus have nothing to recover from. Finally, weak demand from



BusinessWeek Economic Forecast Survey For 2002

FIRM	PERCENT CHANGE IN REAL GDP ANNUAL RATE					4-QTR. PERCENT CHANGE GDP	CPI	FEDERAL FUNDS RATE	10-YR. TREASURY YIELDS	JOBLESS RATE
	2001 IV	I	2002 II	III	IV					
T. DiCLEMENTE Citigroup	-1.8	1.0	3.1	5.9	5.2	3.8	2.0	2.50	5.55	5.5
D. O. RIPPE Prudential Securities	-2.0	2.8	3.5	4.3	4.5	3.8	2.9	3.50	5.50	5.8
NAROFF Naroff Economic Advisors	1.6	4.1	3.3	4.2	2.6	3.7	2.2	3.75	5.75	4.8
E. KRETZMER Banc of America Securities	-0.9	2.2	3.9	4.6	3.9	3.6	2.5	3.80	5.60	5.7
LITTMANN Comerica Bank	1.8	3.3	3.1	3.8	4.5	3.6	1.6	2.50	5.25	5.5
D. YAMARONE Argus Research	-0.9	2.1	3.9	4.0	4.1	3.5	3.6	4.50	5.70	5.1
E. R. ENGLUND Standard & Poor's MMS	-1.0	1.0	3.8	4.0	5.0	3.4	2.7	3.00	5.25	6.2
D. SWONK Bank One	-2.0	0.1	3.8	5.0	4.6	3.4	2.0	3.00	5.10	6.1
E. LAUFENBERG American Express Fin. Advisors	1.6	3.6	2.8	3.0	3.2	3.2	3.7	3.00	5.30	5.5
T. McGEE Tokai Bank	-0.5	2.5	3.3	3.6	3.2	3.2	2.8	2.31	5.87	6.4
JEILL Bank of Montreal/Harris Bank	-2.0	1.0	3.4	4.1	4.3	3.2	2.5	2.85	5.90	5.6
EPHERDSON High Frequency Economics	1.0	2.5	3.5	2.5	4.0	3.2	1.7	3.00	5.75	7.3
J. KEN & C. VARVARES Macroeconomic Advisers	-2.0	2.5	3.5	3.3	2.9	3.1	2.2	3.67	5.34	5.8
RESLER Nomura Securities International	-1.2	2.4	3.8	3.4	2.8	3.1	1.5	1.50	5.25	5.7
T. SHROUDS DuPont	-1.4	2.4	2.8	3.9	3.4	3.1	1.9	2.25	5.00	5.9
J. N. GALLAGHER Soci�t� G�n�rale	-1.5	1.0	2.5	4.5	4.0	3.0	2.5	2.60	5.60	5.7
STEINBERG Merrill Lynch	-1.0	-1.0	3.0	5.0	5.0	3.0	1.3	2.65	5.25	6.1
S. W. SYNNOTT U.S. Trust	0.0	1.4	2.8	3.3	4.4	3.0	2.9	2.25	5.20	6.0
D. J. DEKASER National City	-1.6	1.1	3.2	3.5	3.9	2.9	2.4	3.51	5.60	5.8
LYLAND ClearView Economics	-1.1	0.0	3.3	3.8	4.4	2.9	2.2	2.62	5.42	5.9
W. BERSON Fannie Mae	-2.4	0.7	2.4	4.0	3.9	2.8	1.8	3.25	5.03	5.7
HENEY John Hancock Financial Services	-2.0	1.5	2.5	3.5	3.5	2.8	2.4	4.00	5.00	5.6
HOOPER Deutsche Banc Alex. Brown	-1.5	-0.3	2.5	4.2	4.8	2.8	2.2	2.50	5.00	6.1
E. L. MORAN Daiwa Securities America	-1.0	1.4	3.3	3.2	3.5	2.8	1.9	4.00	5.50	5.8
D. BERNER Morgan Stanley	-1.7	-0.6	1.3	5.0	5.3	2.7	1.8	2.88	4.85	6.3
ANTINE G. SORAS Biovest International	-1.7	0.9	2.4	3.5	4.0	2.7	2.6	3.41	5.47	5.7
NCE GOODMAN Globalecon	-0.7	0.6	2.9	3.2	3.7	2.6	1.7	2.50	5.80	5.7
ONSKI Moody's Investors Service	-0.2	1.5	2.5	3.0	3.5	2.6	1.7	3.08	5.60	5.5
E. L. NIEMIRA Bank of Tokyo-Mitsubishi	-0.9	0.3	2.5	4.1	3.6	2.6	3.1	3.80	5.40	5.8
T. H. SCHNORBUS J.D. Power & Associates	-2.1	0.2	2.5	3.6	4.0	2.6	1.5	2.50	5.10	6.5
OPHER LOW First Tennessee Capital Markets	-0.5	1.3	2.7	2.9	3.2	2.5	1.7	1.75	4.70	5.8
NON SOHN Wells Fargo	-1.5	0.2	2.6	2.8	3.5	2.5	2.4	2.25	6.25	5.4
I. LIRO Stone & McCarthy Research	0.0	-1.0	2.5	3.5	4.5	2.4	2.8	1.96	6.00	5.6
HARRIS UBS Warburg	-2.0	-1.0	3.0	3.2	4.0	2.3	1.9	1.60	5.00	6.2
ER & E. HARRIS Lehman Brothers	-2.5	-1.5	3.0	3.5	4.0	2.3	1.6	3.25	5.00	6.4
OSLER The Conference Board	-0.8	1.7	1.2	2.2	3.9	2.2	2.6	3.47	5.16	6.2
LAS S. PERNA Perna Associates	-1.3	-2.1	2.5	4.4	4.1	2.2	2.6	2.50	5.60	6.5
ZANOI Economy.com	-1.3	-0.3	0.8	3.7	4.6	2.2	2.3	3.70	5.60	6.2
UA NG Federal Express	0.5	-1.2	1.7	3.7	4.0	2.1	2.1	2.50	4.50	6.0
J. R. HARRIS HSBC Bank USA	-1.5	-1.5	2.0	4.0	4.0	2.1	2.0	2.10	5.25	6.3
ANGELL Angell Capital	-1.0	0.0	2.3	2.6	3.0	2.0	0.6	1.75	4.00	6.5
NY CHAN Banc One Investment Advisors	-0.5	0.5	1.0	3.0	3.5	2.0	1.8	2.00	5.05	6.4
PER & K. MAOIGAN BusinessWeek	-1.0	0.0	2.0	3.0	3.0	2.0	1.8	2.00	5.10	6.7
IM C. DUNKELBERG Natl. Fed. of Indep. Business	0.3	0.9	1.8	2.3	2.7	2.0	2.7	1.50	4.80	6.0
T. G. HOFFMAN PNC Financial Services	-2.5	-1.0	1.5	3.5	4.0	2.0	2.5	2.40	5.05	5.9
LEREAH National Association of Realtors	-1.5	0.1	1.9	3.0	2.9	2.0	2.1	2.50	5.10	6.0
ORR Wachovia	-2.0	-1.0	1.2	4.0	4.0	2.0	2.0	2.13	5.20	6.5
A. SHAPIRO Maria Fiorini Ramirez	0.6	-0.1	1.2	2.7	3.7	1.9	2.0	2.50	5.75	6.4
LOGAN Dresdner Kleinwort Wasserstein	-2.0	-0.5	2.6	2.2	2.9	1.8	1.7	2.00	5.20	6.3
PAULSEN Wells Capital Management	-1.0	1.0	2.5	1.5	2.0	1.8	0.9	1.40	4.00	6.2
N. WOOD FinancialOxygen	-1.0	-2.0	1.5	4.0	3.0	1.6	1.8	3.30	5.10	6.3
IM C. QUOLEY Goldman Sachs	-1.5	-1.0	0.5	3.5	3.0	1.5	2.0	1.50	4.30	6.8
IT A. BRUSCA Ecobest Consulting	-1.5	-1.4	0.3	3.6	2.9	1.4	2.8	2.00	6.00	6.4
KARL Swiss Re	-2.6	-2.0	-0.2	3.5	4.1	1.3	2.2	3.25	5.30	6.4
SINAI Decision Economics	-0.3	-1.5	0.7	2.4	3.0	1.2	1.5	2.64	4.97	6.2
IONS Huntington National Bank	-2.6	-1.7	0.6	2.5	3.0	1.1	2.5	3.50	5.40	6.2
MICHAELIS Weyerhaeuser	-2.7	-1.0	0.5	1.9	2.3	0.9	2.1	2.00	4.00	6.6
O. STRASZHEIM Straszheim Global Advisors	-2.0	-2.0	0.0	2.0	2.0	0.4	1.7	2.25	5.50	7.0
POPE Investment Economics	-0.6	-0.7	-0.4	0.1	1.1	0.1	3.3	2.05	5.70	6.5
ENSUS	-1.1%	0.4%	2.3%	3.4%	3.7%	2.5%	2.2%	2.7%	5.2%	6.1%

A Global View of 2002

abroad will not dissipate until after the U.S. recovery is established.

No one in the survey thinks these countervailing forces will prevent a recovery, but nearly all believe they will limit the upturn's oomph. On average, the forecasters expect growth of 1.5% in the first half and 3.5% in the second. That's only a shade above the economy's sustainable, noninflationary pace of 3% or so. It's also well below the norm in past recoveries, when growth typically exceeded its long-term trend, a necessary condition for putting workers and machines idled by the recession back to work. The recovery's gradual pace will push the jobless rate to a peak above 6% in the sec-

leashed a record volume of mortgage refinancings that is putting extra cash in people's pockets. And consumer balance sheets are in good shape. "The rise in gross assets in recent years lifted especially by rising home prices, has been many times bigger than the increase in gross debts, which in my view is a red herring," says Ian Shepherdson of High Frequency Economic Plus, Stephen Slifer and Ethan S. Harris at Lehman Brothers Inc. think the low 1% household saving rate, measured as a percentage of aftertax income, is not such a big issue, either. "We found that if realized capital gains are included, and the saving rate recalculated, it dipped from 10% in 1990 to 8% in 2000."

So far, the resiliency of household spending has cushioned some of the blows from sharp cutbacks in capital spending and the largest liquidation of inventories in the postwar period. But in the first half of 2002, an end to inventory liquidation will be

	REAL GDP PERCENT CHANGE			CPI PERCENT CHANGE			EXCHANGE RATE UNITS PER U.S.\$*		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
CANADA	4.4	1.4	1.4	2.7	2.7	1.7	1.54	1.57	1.51
MEXICO	6.9	0.1	1.6	9.5	5.8	5.6	9.40	9.48	10.02
BRAZIL	4.5	1.3	1.5	7.0	6.3	5.3	1.98	2.60	2.67
EURO ZONE	3.4	1.6	1.6	2.4	2.7	1.8	0.89	0.92	0.92
BRITAIN	3.1	2.2	2.1	2.1	2.1	2.3	1.45	1.46	1.44
JAPAN	2.4	-0.8	-0.7	-0.7	-0.7	-0.7	11.10	12.28	12.41
KOREA	8.8	1.7	3.3	2.2	4.0	2.9	12.19	12.97	12.58

*Britain and euro zone are U.S. \$ per unit; exchange rates are end of year

Data: Blue Chip Economic Indicators

ond half, while inflation slows to below 2%.

The biggest obstacle to faster growth in 2002 is the fallout from past overinvestment in technology, which has depressed demand for new equipment and created a huge pileup of tech inventories, causing one of the most severe downturns in industrial output since the Great Depression. "The main headwind...is the investment overhang caused by the 'irrational exuberance' of corporate management at the height of the Internet bubble," says Joseph Liro of Stone & McCarthy Research Associates. Or, as William C. Dunkelberg at the National Federation of Independent Business puts it: "This is a too-much-stuff recession." Too much capital equipment. Too much inventory. Too much labor.

Companies are making some progress with a little help from consumers, but the outlook for households is mixed. The biggest minuses are uncertainty over rising layoffs and the war against terrorism, both of which are depressing confidence, and the lack of pent-up demand that recessions usually generate. However, consumers have several plusses. "Once employment stops falling, the consumer sector will be well-supported by tax cuts, falling energy prices, and improved net worth—both from home values and stocks," says Richard D. Rippe at Prudential Securities Inc.

In addition, lower interest rates have un-

dermined the need to shore up factory output. "I expect an inventory-led recovery, with the manufacturing sector moving up," says Robert Shrouds of DuPont. "The old economy, such as autos, will move up first, [followed by] a second leg up in the tech sector." Gains in capital spending will require profit margins to stabilize. "That's not happening yet," says Ian Morris at HSBC USA, "but slower wage growth, falling energy prices, and continuing productivity gains should all begin to help margins recover so that investment will grow reasonably stronger in the second half."

A full recovery in capital spending may not come until 2003. Business outlays for equipment and construction typically turn up after the economy does, as companies wait to see demand and profits improve before shelling out for new projects. The problem this time is that a slow recovery in demand will come on top of the past overinvestment. Equipment outlays, especially for high-tech gear, doubled from 1994 to 2000

four times the pace of overall output, and the level of new investment remains historically high relative to cash flow.

Nor will companies be able to look abroad for much new business (table). The global downturn will continue to hammer U.S. exports. The 12-nation euro zone is close to—or perhaps already in—a recession, and growth prospects there in 2002 will be limited by rising unem-

Surplus Blues

*William C. Dunkelberg:
"This is a too-much-stuff
recession." Too much
capital equipment. Too
much inventory. Too
much labor.*

ployment. Japan will remain a basket case, as policymakers quibble over how to deal with banks' nonperforming loans. The rest of Asia will not turn around until the U.S. and its tech industries do. The same is true of Mexico, while Brazil and Argentina have their own homegrown problems.

Despite the unusual nature of this recession and the added downdraft from September 11 and the war, the biggest plus going for the economy in 2002 is stimulative policy. "I cannot find any other recession in the last 50 years that has been met with as much countercyclical fire power as this one has," says Anthony Chan of Bancroft Investment Advisors. Given that Fed rate cuts typically take 6-12 months to work through

the economy, nearly half of the Fed's cuts have not yet been felt. Coming tax cuts and the boosts to government spending associated with the war and homeland security will also add to growth.

Almost all of the economists based their forecasts on the thesis that the U.S. will not be hit with any new terrorist attacks. A risky assumption, perhaps, but any assault may not affect the economy as sharply as the September 11 events did. As Diane C. Swonk of Bank One puts it, "the ability of those events to disrupt commerce...has been greatly diminished. We have already lost that side of our innocence and, as a result, can't lose it again."

With James Mehring in New York

THE POWER OF NEGATIVE THINKING

Sometimes, the last really are first. Last December, the 54 forecasters surveyed by *BusinessWeek* expected that real gross domestic product would grow, on average, 3.1% in 2001, and the jobless rate would be just 4.3% by yearend. Instead, real GDP grew by less than 1% and unemployment hit 5.7% in November. Given the general overoptimism, *BusinessWeek's* most accurate forecaster for 2001 was the gloomiest: James W. Paulsen, chief investment officer of Wells Capital Management in Minneapolis, who predicted growth of 1.7% in 2001.

Because of his dim view on growth, Paulsen was also the most accurate on inflation, unemployment, and monetary policy. (In ranking the forecasts, *BusinessWeek* scored the results only up to the third quarter, so the attacks on September 11 had little effect on the results.)

Paulsen based his outlook on the events following the Asian crisis of 1997. "That crisis was a phenomenal warning shot across the bows of the industrial nations," he says. "It exposed the disinflationary world we live in," characterized by excess supply and sluggish demand. In his view, this new era, which prevails today, forced companies to pursue cost-cutting to avoid a profit meltdown.



DIM VIEW: Paulsen's 2001 forecast was most accurate

Companies focused on tech investment as the best way to lift productivity and lower costs. This capital spending boom fueled economic growth in the late 1990s.

In late 2000, though, "it was hard to see what was going to drive growth [in 2001], and no policy stim-

ulus was in place back then," Paulsen says. Manufacturing was already hurting, and short-term interest rates were higher than long-term ones. He expected the Federal Reserve to cut interest rates and the new Administration to put in place a modest stimulus package. But he didn't think the moves would come soon enough to stop a rise in the jobless rate.

Looking at 2002, the 43-year-old Paulsen is again downbeat. "We'll recover, but it won't be what people expect," he says. "We'll be in the 2% mode." He rules out 3% to 4% growth because there's not enough pent-up demand to fuel spending by consumers, and businesses still have an overhang of capital equipment. Paulsen says he wouldn't be surprised if the Fed lowers the fed funds rates in late 2002 to close to 1% to pump up growth in 2003.

Paulsen grew up in Iowa and built his career at various Midwestern firms. He notes that "not coming up through the Wall Street ranks gives you a different perspective." That outlook helped Paulsen outscore his fellow economists in 2001. Should he prove the most accurate again in 2002, the U.S. faces another painful year.

*By Kathleen Madigan
in New York*



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Belt-Tightening Time Inside the Beltway

But will Congress cooperate in an election year?

BY RICH MILLER

In 2001, Washington policymakers spent much of their time shoveling money out the door. In a failed attempt to stave off recession, Federal Reserve Chairman Alan Greenspan slashed interest rates to their lowest levels in four decades. President Bush rammed a \$1.3 trillion tax cut through Congress in the summer, then blessed \$40 billion in emergency government spending following the September 11 terrorist attacks. The putatively laissez-faire Bush also backed a \$15 billion bailout for the airlines and paved the way for import protection for steelmakers.

Now, with the economy widely expected to pick up in the first half of 2002, policymakers face the less palatable task of tightening their belts.

At the Fed, that means deciding how much, if any, of 2001's cuts to take back. For Bush and congressional leaders, it means making tough choices about where to cut government spending to rein in reemergent budget deficits.

In the bond market, there's little doubt that the Fed will respond promptly and aggressively

GREENSPAN

AND BUSH: Fed officials don't foresee rapid-fire rate hikes

to any signs of recovery. Future markets are pricing in 1½ percentage points or more of Fed tightening in 2002, starting in the second quarter. But Fed officials—even inflation hawks—believe market expectations of rap-

id-fire rate hikes are overblown. For one thing they're not as convinced of an early, V-shaped recovery as the markets are. Moreover, they are not overly worried about a pickup in inflation even if the recovery arrives earlier and turns out to be stronger than they expect. In fact, with unemployment rising and factories operating at just 75% of capacity, Greenspan & Co. are looking for inflation to fall, not rise, in 2002.

Of course, the money mavens don't rule out rate hikes: A modest rise in short-term rates toward the end of 2002 seems like a good bet. After all, some of the cuts since September 11 were undoubtedly intended to guard against a complete collapse of the economy after those attacks. As the recovery becomes more firmly ensconced later in the year, look for the Fed to gently nudge rates back up about three-quarters of a percentage point.

On the fiscal front, White House Budget Director Mitch Daniels has already told Congress that budget surpluses could be history if lawmakers don't rein in federal spending. While the White House is willing to give a free pass to defense and homeland security, it will red-pencil other requests for stepped-up expenditures.

Budget experts, however, say Daniels' tough talk may not amount to much. Sure, the Administration is likely to propose a tightfisted budget in February—officials predict the Bush budget will boost nonwar spending by just 2% to 3%. But there's little chance that lawmakers will agree to such tough curbs on spending in a congressional election year.

More action is likely on the regulatory front. In the wake of Enron Corp.'s collapse, Securities & Exchange Commission Chairman Harvey L. Pitt is expected to put forward new rules on financial disclosure so that investors have a clearer idea of what companies are up to. He'll also give the audit committees of corporate boards more responsibility in overseeing what their accountants and auditors are doing. Restrictions are

likely on companies stuffing employee 401(k) plans with the company's own stock, as Enron did.

All in all, it looks like a busy year. Not as frenetic as 2001, but lively enough to keep investors on their toes.

What's In Store from Washington

INTEREST RATES

Small increases by the Fed toward the end of the year as the recovery becomes firmly established

BUDGET DEFICITS

A lot of hand-wringing by the Hill and White House over their sudden reemergence, but little action

REGULATIONS

New SEC rules on financial disclosure and possible pension reforms in the wake of Enron's collapse

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Six Signs of Recovery

Not all tea leaves are created equal. Some reports do foreshadow upturns

ECONOMIC INDICATORS

CONSUMERS Consumer spending is the linchpin of this economy, and happy consumers tend to spend more than pessimistic ones. So watch these two reports: The University of Michigan's Consumer Sentiment Index, released twice a month, and the Conference Board's Consumer Confidence Survey, out on the last Tuesday of each month. Both indicators plunged in recent months. You'll know when consumers are feeling better when Sentiment readings—now at 85.8—are consistently above 90, and when Confidence—now at 82.2—rises above 100.

NUMBERS TO BEAT

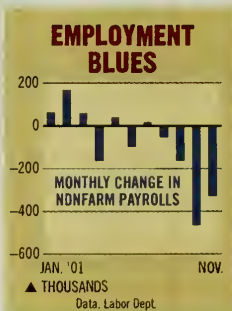
University of Michigan's Consumer Sentiment Index

+90

Conference Board's Consumer Confidence Survey

+100

JOBS Few things make consumers happier than knowing that the labor market is healthy. That's why the Labor Dept.'s employment report, released the first Friday of every month, is worth watching. Zoom in on the change in nonfarm payrolls. The latest report shows that jobs plunged 331,000 in November. A sign of an economic rebound will be back-to-back monthly increases in nonfarm payrolls.



CAPITAL GOODS Business spending, especially on equipment, has to kick in if the economy is to bounce back, so keep an eye on capital-goods orders. It's a component of the Census Bureau's durable-goods orders report released at the end of each month. A consistent rise in capital-goods orders, excluding aircraft, will be a good indication that business spending on equipment is turning around.



STOCK MARKET INDICATORS

MOMENTUM One sign of a bull market is that investors are willing to pay higher prices. That's why market pros watch the 200-day moving average of the Standard & Poor's 500-stock index. To calculate it, add up the closing index prices for the past 200 trading sessions and divide by 200. When the current price is higher than the average—and stays that way—it's a bullish sign. The 200-day moving average can be found each week on BW's Investor Figures of the Week page.



BREADTH A rising market index doesn't mean much if all the gains are in a few stocks. You need to look at the market's breadth by comparing the daily number of advancing issues to the number of declining issues on the New York Stock Exchange. In early stages of bull markets, there has usually been one day, and sometimes two or three days, within a few weeks' span when advancing issues were five times greater than declining issues. Since the Sept. 21 low, advancing issues have only been 3.6 times greater.

THE BIG MOVE

Look for at least one day when the ratio of Board stocks advancing to those declining

5 to 1

SENTIMENT Excessive pessimism often brings in the bulls. That's why we track the trading of "put" and "call" options. Put buyers are bears, call buyers are bulls. A weekly average of the put-call ratio is in BW Investor Figures of the Week. When the stock market is making a bottom, this ratio is at least 0.9. During market pullbacks, watch for the ratio to meet or break 0.9. That will be a sign that prices have room to rise.

CONTRARY OPINION

Put-call ratio should be at least

0.9

during market sell-offs

"Just order the standard computers."

Translation: By standard I mean configured just like mine.



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Onward—and Mostly Upward

The stock resurgence is here to stay, say the bulls

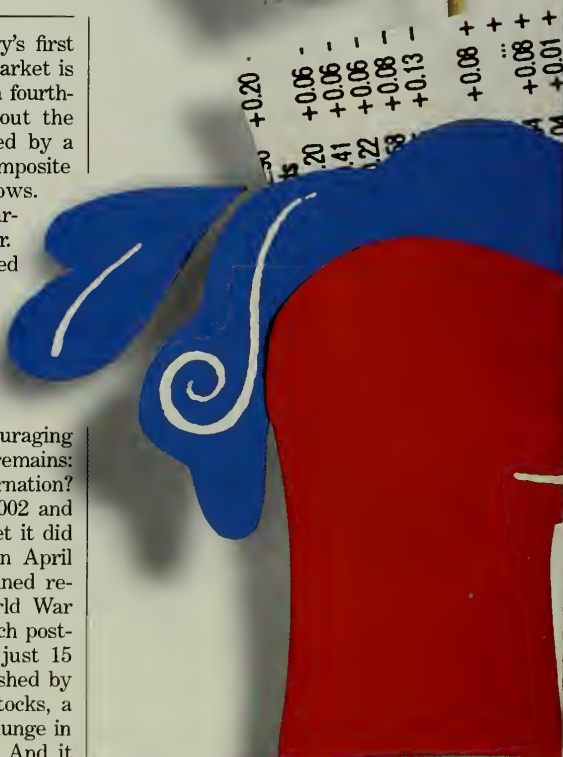
BY MARA DER HOVANESIAN

Two years into the 21st century's first bear market—and the stock market is partying like it's 1999. In fact, a fourth-quarter rally has brought about the highest returns since then—led by a 37% surge in the Nasdaq Composite Index since the Sept. 21 lows.

That's hacked the tech-laden index' year-long losses to two-thirds those of last year. The Dow Jones industrial average gained 19% in less than three months, and the Standard & Poor's 500 index climbed 8%. The recent gains in the broader market are impressive, but the Dow is still on track to lose 8% this year, and the S&P to lose 13%.

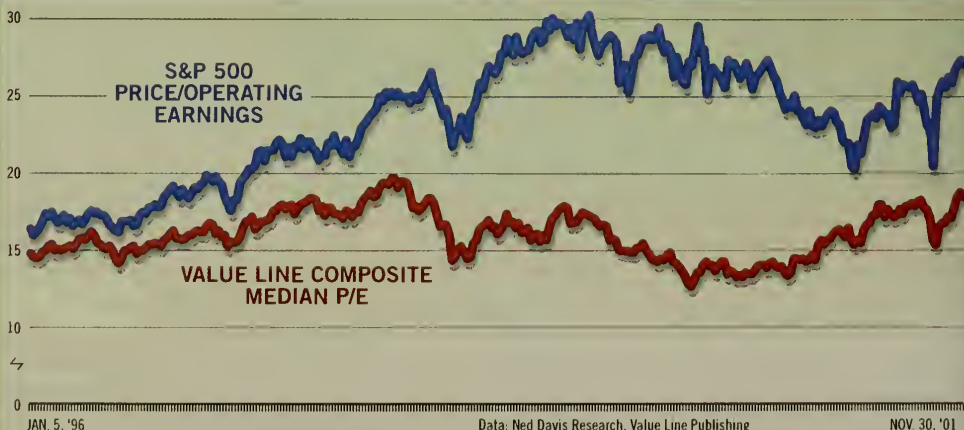
The market's new momentum is encouraging hopes for the future. But the question remains: Has the bear finally gone back into hibernation? Or will it go on the rampage again in 2002 and ruin the yearend festivities, as the market it did this summer, when a rally that began in April fizzled out? A key argument for a sustained rebound is historical precedent. Since World War II, there have been 10 bear markets, which posted average declines of 29% and lasted just 15 months. The current bear market—unleashed by the collapse of speculation in Internet stocks, a rout in business capital spending, and a plunge in profits—has lasted longer, at 19 months. And it

DEC Pharm	DEC	...	104
Index at	OP	s	cc 324
IDX Sys	IDXX	...	27 2
IDX Sys	IDXC	...	37
IEC Electro	IECE	...	dd
IFCO Sys	IFCO	...	...
IFR Sys	IFRS	...	d
IGEN Int	IGEN	...	...
II-VI	IVI	...	...
IKOS Sys	IKOS	...	...
ILEX Onc	ILXO	...	...
ILOG	ILOG	...	8
IMPCO Tch	IMCO	...	...
I-Many	IMNY	...	...
IONA Tch	IONA	...	...
IPC Hldgs	IPCH	...	...
IRIDEX	IRIV	...	...



Small-Cap Catch-Up Ahead

Small-cap valuations are on the rise again, closing the gap with large caps that opened in the late 1990s



Data: Ned Davis Research, Value Line Publishing

is cut deeper, with declines in individual stocks of nearly 40% on average.

But these are exceptional times, and history perhaps not a good guide. The economy and the nation have been gripped by unusual uncertainties, many stemming from the terrorist attacks of September 11. And earnings are still abysmal: S&P operating earnings will probably post a decline of 3.4%, the worst since the 1950s, says Morgan Stanley chief investment strategist Steve Galbraith.

Indeed, the earnings



drought of 2001 surpasses those of 1982 and '91—two recessionary years in which earnings fell 17% and 12.8%, respectively. A preliminary consensus estimate of 19% lower earnings in the fourth quarter alone is the fifth decline in a row, the first time since 1969 there has been such a stretch of poor performance, according to Thomson Financial/First Call. The actual results are a far cry from the hopes of last January, when the analysts' consensus forecast for S&P earnings growth was 7% for 2001. Last year, Merrill Lynch & Co.'s former U.S. investment strategist, Christine Callies, predicted in these pages that the S&P would gain 22% in 2001.

Despite forecasts gone awry and disappointing profits, the spirits of Wall Street stockpickers and strategists are high. "The market is betting on a recovery, and we are too," says Robert C. Elliott, senior managing director at New York's Bessemer Trust Co., which oversees \$35 billion. Elliott and others point to falling business inventories, which are starting to prompt new manufacturing orders. Inflation is tame, and the Federal Reserve is precast among analysts—although likely to be trimmed somewhat—is for a 15.3% gain in the S&P next year. "Not that it's a powerful expansion, but this is the point we should anticipate things getting better," says George Cohen, a principal at Cohen, Klingenstein & Marks, managers of \$4 billion in equity assets. "We've pretty much taken care of the excesses."

Arguably, the rosy forecast for next year still puts S&P stocks trading at somewhere near 27 times trailing earnings—a price too dear for some,

since historical price-earnings ratios hover around half that. Sure, "that's way above the average, but you have to go deeper," argues Gail P. Seneca, chief investment officer at Seneca Capital Management. Low inflation means investors will reap more of their nominal stock gains, while low interest rates will keep them in equities. "The real work is to find companies that can produce earnings that warrant this type of a multiple," she says.

For her money, Seneca is banking on large tech stocks such as Dell Computer Corp. and Intel Corp.—companies that gained market share in the downturn and will surge first in a rebound, she says. Small-cap companies with solid earnings growth and top-grade managers also make the cut, such as Jabil Circuit Inc., an independent electronic manufacturer, and pharmaceutical outfit Biovail Corp. Adds William H. Miller III, portfolio manager at Legg Mason Inc. and one of the few mutual-fund managers to beat the S&P 500 every year for more than a decade, the market is near bottom. "It may not be this quarter or next, but it doesn't matter. We're bullish," he says. Miller's \$8.9 billion Legg Mason Value Trust fund is down 12.53% through Dec. 14, vs. the S&P's 13.86% loss.

Although the bulls appear to be stirring again, investors shouldn't count on a market moving upward in a straight line. "We are going to have a series of bull and bear markets," says Richard E. Cripps, equity strategist at Legg Mason. He forecasts average market returns of 7% in 2002. Cripps is leery about large blue chips that have high fixed costs and big restructuring challenges ahead, and he sees continued momentum among undervalued smaller stocks. Another bright note: Money market assets are at a record \$2.3 trillion. As investors tire of measly 2% returns, they could dip more earnestly into stocks. If that's so, it might be enough to keep the bull running and the bubbly flowing.

FOR THE RECORD

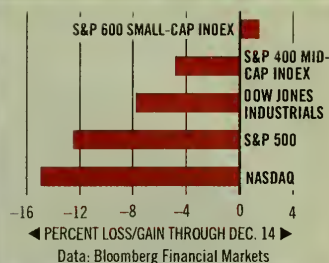
Seneca's San Francisco firm manages \$15.2 billion, including \$1 billion in stock and bond mutual funds

ON MARKETS The market is moving up strongly. The worst is behind us.

ON GROWTH VS. VALUE Value has been in favor for two years: It's time for growth stocks to take over the lead again.

ON TECH It's a good sector for 2002. It has already borne the brunt of the downturn. Tech stocks have a very, very strong chance of showing favorable return comparisons next year.

Large Stocks, Big Tumble



BusinessWeek online

For more on what top stock pickers are advising, go to the Dec. 31 issue online at www.businessweek.com



GAIL P. SENECA
Chief Investment Officer
Seneca Capital Management

She's banking on growth stocks



A Fresh Strategy For Bonds

Earnings will come from yields, not price gains

BY SUSAN SCHERREIK

Bonds have beaten stocks for two years running. But don't count on that in 2002. Thanks to the Federal Reserve's 11 rate cuts in 2001, short-term U.S. Treasury yields dipped to their lowest levels in decades. However, in the past six weeks, bond rates have begun creeping back up amid expectations that the economy will recover in 2002.

You can still make money in bonds. But today's environment calls for fresh strategies. "Over the past two years, bond investors earned most of their return from price gains, but 2002 will be about yield plays," says Kevin Cronin, chief investment officer for fixed income at Putnam Investments. William H. Gross, portfolio manager of PIMCO Total Return, the nation's largest bond fund with \$48.8 billion in assets, agrees. "Fears of a bear market in bonds over the next 12 months are exaggerated," Gross said in recent comments. "But that still begs the question of how to make money if the bull mar-

ket is over and Treasury yields are slow," he continued. Gross's solution is to "buy higher yielding bonds that trade at significant spreads to U.S. Treasuries." His figures this strategy should produce a 6.5% to 7% yield, which he notes, is "not too shabby in a world of 1.5% inflation."

So which bonds offer the best yield deals right now? Among high quality bonds, mortgage backed securities, investment-grade corporate and municipal bonds are the best bets. These boast solid credit quality but are yielding as much as two percentage points more than comparable Treasuries. Now is also a good time to dip into high-yield bonds, which are yielding more than seven percentage points, on average, than comparable Treasuries. Investors who can stomach more risk should also consider emerging market debt. The well-publicized debt problem of Argentina aside, emerging market bonds have recently been strong performers and yield as much as 10 percentage points more than Treasuries. Amy Falls, global fixed-income strategist at Morgan Stanley Dean Witter, believes both junk bonds and emerging market debt could be big winners if the global economy recovers in the latter half of 2002.

Among high-quality bonds, Putnam's Cronin believes mortgage-backed securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac are hard to beat. The issuers' creditworthiness is just below that of the U.S. Treasury, yet yield as much as two percentage points more than comparable Treasuries. Why? Investors haven't bid up the prices because they're worried that mortgage rates will start to decline again. If that happens, homeowners will pay off those higher-yielding mortgages, leading to redemptions of the bonds.

Cronin doesn't anticipate that prepayment problem. He says there are two opposing forces at work that should keep rates steady. On one hand, the economy will strengthen enough to keep mortgage rates from coming down any fur-

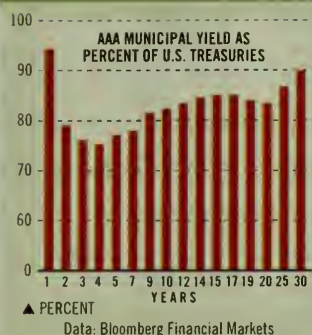
er. At the same time, he believes that inflation will remain tame enough to keep long-term interest rates from climbing.

William T. Lissenden, a fixed-income strategist at Conseco Capital Management Inc. in Carmel, Ind., recommends blue-chip corporate bonds, which yield an average 1.7 percentage points more than Treasuries. The key: Pick companies with the resources to ride out the recession. One is AOL Time Warner Inc., whose cash flow is getting a boost from its megahit film *Harry Potter and the Sorcerer's Stone*. Lissenden also favors Sprint Capital Corp. because of the growth potential of its wireless business.

For investors in the loftiest tax brackets, municipal bonds still offer the best deals. Bruce D. Simon, chief investment officer at Glenmede Trust Co., advises sticking with general obligation, electric utility, and most revenue bonds, except hospital bonds, which could be affected by changes in Medicare reimbursements. Yields on top-quality municipal bonds are over 90% of U.S. Treasuries for the 1- and 30-year maturities, and more than 2% for maturities over 10 years (chart). What this means is that taxable investors give up little in cash payouts to get tax-free interest payments. For instance, 10-year AAA general obligation bonds recently yielded 4.41%. That's the equivalent of 6.84% in a taxable security for those in the 35.5% federal tax bracket.

For those who want to take some risk, consider munis from the New York City area. Joseph P. Deane, portfolio manager of the Smith Barney Managed Municipals fund, says the bonds of the Port Authority of New York & New Jersey and the Triboro Bridge & Tunnel Authority offer good value. "The prices of Triboro bonds declined sharply after September 11 because investors thought bridge and tunnel toll revenues would fall sharply after the terrorist attacks," Deane says. That has not happened, however, because local tolls haven't been much affected, he says. Triboro Bridge & Tunnel bonds maturing in 15 years are rated AA-, yield 5.48%, and, for New York City residents, are exempt from city, state, and federal taxes.

Mighty Munis



yields are so high, you can still suffer some credit losses in individual junk-bond issues but come out ahead of Treasury rates," she says. Patel, however, stresses that junk remains a risky investment. She notes that the junk-bond default rate, recently at 9.8%, isn't expected to peak for another few months. Two areas to avoid, she says, are the telecom and airline sectors.

It's tough for individuals to buy junk bonds because institutions dominate the market and many issues are thinly traded, making it hard to sell them quickly. So look for junk-bond funds with proven track records and seasoned managers. Alan Papier, an analyst at Morningstar, favors PIMCO High Yield, Pioneer High Yield, and the Vanguard High-Yield Corporate funds.

Investors who can take on even more risk should try emerging market debt. Morgan Stanley's Falls believes such debt, especially the bonds of Brazil, Russia, Ukraine, and Peru, will benefit as the global economy rebounds next year—despite Argentina's problems. "The countries we like have sound fiscal policies, and their prospects aren't likely to be impacted by Argentina," she says. Those countries' bonds are yielding 5 to 10 percentage points more than Treasuries. Two top funds in this sector are PIMCO Emerging Markets and Fidelity New Markets Income.

Bonds may not perform in 2002 the way they did in the past two years. Still, as investors have surely learned lately, bonds in your portfolio will go a long way toward protecting your wealth.

With Lewis Braham in New York

Fears of a bear market in bonds are overblown

Best Bond Buys

INVESTMENT	AVERAGE YIELD*	COMMENT
EMERGING MARKETS BONDS	10.25%	Argentina's fiscal troubles aside, this sector is humming and should continue to do well in 2002.
HIGH-YIELD BONDS	12.92	As the economy recovers, junk bonds should, too. Potentially the bond market's biggest winner over the next 12 months.
INVESTMENT-GRADE CORPORATES	6.43	Stick with blue-chip companies with the resources and cash flow to survive today's tough business climate.
MORTGAGE-BACKED SECURITIES	6.36	Securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac yield as much as two percentage points more than Treasuries.

*Dec. 14 Data: Merrill Lynch, *BusinessWeek*



The Bull May Run— Just Not Too Fast

Analysts expect a modest rally following a grim 2001

BY ANNE
TERGESEN

Is the stock market's rally from the September lows the beginning of a new bull market or just another bear trap? *BusinessWeek's* survey of 54 fearless stock market forecasters found that most think the bull is coming back. But don't get too excited. They believe this bull will be less robust than its predecessor, which racked up years of 20%-plus gains.

Indeed, the seers' predictions for 2002 are downright moderate. They are, on average, looking for a 13% rise, to 11,090, for the Dow Jones industrial average; a 15% increase, to 1292, for the Standard & Poor's 500-stock index; and a 14.5% jump, to 2236, for the Nasdaq Composite Index. While impressive after two nasty years, those gains would still leave the indexes from 4.3% to 55.7% below the highs hit in early 2000. "Although 2002 will be a recovery year, it's not going to be nearly as good as a typical recovery

year," says Rod Smyth, chief investment strategist at First Union Securities.

True, the economy is getting a potentially powerful kick from aggressive interest-rate and tax cuts and a big fall in energy prices. Yet the forecasters believe recovery will be constrained by rising unemployment and heavy debt loads, which will keep consumer spending in check. Corporations, still working off excesses from boom years, aren't in a position to binge either.

If the economy is going to rebound modestly, it's unlikely stocks can do much more. Just look at the outlook for corporate profits. Our forecasters think they'll jump 13% in 2002. That's far below the 23% profit rebounds seen in 1983 and 1975, when the economy was also emerging from recession, says Jeffrey Kleintop, chief investment strategist at PNC Advisors in Philadelphia. More

over, about one-quarter of that gain will result not from improved business conditions but from an accounting change, he says. In 2002, rules no longer require companies to deduct from annual earnings a portion of the goodwill associated with the costs of previous mergers.

The forecasters are more upbeat about the interest-rate prognosis. With many industries swimming in excess capacity, competition remains fierce enough to keep price increases in check—and the Federal Reserve from making a about-face on rates, says Richard Dickson, market analyst at Hilliard Lyons in Louisville.

But if the monetary and fiscal stimuli in the pipeline ignite a stronger-than-expected recovery, all bets on inflation are off. "A year from now we'll be asking when the Fed is going to raise rates, if they haven't done it already," says Robert Stovall, market strategist at Prudential Financial and one of Wall Street's most vocal bulls (table). Rising rates could dampen the outlook for equities in 2003, Stovall predicts.

The pros' crystal balls did not serve them well in 2001. Last December, most expected the Fed to cut interest rates enough to avert a recession and propel the Dow to 12,015—almost 2000 points above where the index stood when *BusinessWeek* stopped the clock on its contest of Dec. 7. They missed the Nasdaq by an even wider mark in percentage terms, forecasting a finish of 3583, vs. the actual close of 2021.

Of course, no one could have foreseen the events of September 11. But even if the terrorist attacks had not occurred, the market would have had to rally by 25%—from 9600 on Sept. 10—to

BusinessWeek Market Forecast Survey for 2002

	OW JONES INDUSTRIAL AVERAGE MIDYEAR	OW JONES AVERAGE YEARENO	STANDARD & POOR'S 500 YEARENO	NASDAQ COMPOSITE YEARENO	RUSSELL 2000 YEARENO	ASSET ALLOCATION*	ASSET ALLOCATION*	ASSET ALLOCATION*	FAVORITE STOCK SECTOR	FAVORITE STOCK
ALVIN MIRMAN vFinance	11500	13250	1535	2139		80	20	0	Technology	NVIDIA
ROBERT H. STOVALL Prudential Financial	11500	13000	1475	2225	531	60	15	15	Health Care	Host Marriott
ROBERT S. ROBBINS SunTrust Robinson Humphrey Cap. Mkts.	11547	12742	1520	2626	647	80	15	5	Retail	Optimal Robotics
ROBERT G. MORRIS Lord, Abnett & Co.	11000	12700	1450	2400	580	60	40	0	Ind. Cyclical	Gap
PHILIP J. DRLANDO Value Line Asset Management	12250	12600	1400	2800	560	85	10	5	Health Care	MedImmune
JOSEPH V. BATTIPAGLIA Gruntal & Co.	11000	12500	1450			70	30	0	Health Care	Ivax Corp.
JOSEPH LIRO Stone & McCarthy Research Assoc.	10900	12090	1400	2410	585	80	10	10	Ind. Cyclical	Nextel
EDGAR PETERS PanAgora Asset Management	11000	12000	1350	2100	600	70	30	0		
STUART T. FREEMAN A.G. Edwards & Sons		12000	1350	2400	575	75	20	5	Media/Comm.	First Data
RICHARD I. SICHEL The Philadelphia Trust Co.	11500	11800	1400	2650	65	25	10		Technology	Bristol-Myers Squibb
ELAINE GARZARELLI Forward Funds		11800	1380			95	5	0	Cons. Durables	Charles Schwab
STEVEN FOLKER Fifth Third Bancorp	11255	11753	1380	2322	559	70	30	0	Technology	BroadWing
CLARE W. ZEMPEL Robert W. Baird	10785	11565	1335	2210	535	80	15	5	Health Care	Flowserve
EDWARD YARDENI Deutsche Banc Alex. Brown	10000	11500	1265	2000	540	80	20	0	Health Care	Microsoft
J. THOMAS MADDEN Federated Investors	10500	11500	1325	2350	555	58	42	0	Technology	Nokia
SUBODH KUMAR CIBC World Markets	10750	11500	1450	3300	600	75	20	2	Technology	Intel
STEPHEN M. ORISTAGLIO Putnam Investments	10800	11500	1350	2300	550	70	25	5	Financials	Tyco
ROO SMYTH First Union Securities	11000	11500	1300	2100	550	74	25	1	Financials	
BRIAN G. BELSKI U.S. Bancorp Piper Jaffray	11100	11500	1300	2600	525	75	20	5	Technology	Sun Microsystems
JEFFREY APPELEGATE Lehman Brothers		11500	1350			80	10	10	Cons. Durables	Mohawk Industries
DAVID A. KATZ Matrix Asset Advisors	11100	11400	1350	2370	546	80	15	5	Technology	Amer. Power Conversion
TDM GALVIN Credit Suisse First Boston	10700	11400	1375			70	20	10	Health Care	
JOHN J. REGAN Josephthal & Co.	10250	11378	1341	2331	557	90	0	10	Technology	Tyco
GEORGE W. EGAN Spencer Trask Asset Management	10500	11333	1392	2000	515	80	15	5	Financials	D.R. Horton
ART HOGAN Jeffries & Co.	10500	11300	1270	3150	521	75	15	10	Technology	MTR Gaming Group
ION BRDRSON Northern Trust	10290	11270	1250	2234	566	80	15	5	Retail	Southwest Airlines
RICHARD A. DICKSON Hilliard Lyons	9900	11200	1350	2500	510	80	15	5	Cons. Durables	Amgen
DAVID M. BLITZER Standard & Poor's	10400	11100	1300	2260		60	25	15	Health Care	
BARRY HYMAN Ehrenkrantz King Nussbaum	10550	11100	1250	2550	506	70	20	10	Technology	Liberty Media
LASZLO BIRINYI, JR. Birinyi Assoc.	10500	11050	1300	2200	530	80	0	20	Financials	Johnson & Johnson
RYAN M. SAILER Kirkpatrick Pettis		11050	1290	1925		75	10	15	Health Care	Southwest Gas
JIM MOLTZ/JASON TRENNERT ISI Group	10300	11000	1265	2150	525	75	25	0	Financials	AES
ALLAN RONESS ASR Corporate Consultants	10500	11000	1250	2410	520	70	0	30	Health Care	RailAmerica
KURT O. WALTERS Bear Stearns & Co.	10300	10900	1265	2100	500	65	30	5	Cons. Durables	Boeing
JAY FERRARA Ziegler Investment Services	10350	10875	1275	2300	500	60	20	20	Technology	Siebel Systems
JACK ABLIN Harris Bank	11068	10870	1257	2049	513	70	30	0	Services	Tricon Global Restaurants
TOBIAS LEVKOVICH AND TEAM Salomon Smith Barney		10800	1350			70	25	5	Financials	AOL Time Warner
PETER CANELD Morgan Stanley Dean Witter	10250	10750	1300	2250	525	75	20	5	Technology	NVIDIA
CHARLIE CRANE Victory SBSF Capital Management	10100	10700	1250	2130	510	80	15	5	Technology	Sanmina
CHARLES J. PRADILLA SG Cowen Securities	10350	10550	1250	2080	500	70	20	10	Technology	IBM
WILLIAM F. TRUSCOTT American Express Fin. Advisors	9800	10500	1230	2200	510	50	50	0	Health Care	Liberty Media
JEFFREY N. KLEINTDP PNC Advisors	10350	10500	1225	2150	500	60	30	10	Technology	Bristol-Myers Squibb
JAMES PAULSEN Wells Capital Management	10400	10500	1250	2170	515	60	40	0	Cons. Staples	
THOMAS McMANUS Banc of America Securities	9000	10400	1200	2350	500	60	35	5	Health Care	Pfizer
HUGH JOHNSON First Albany	10000	10400	1245	2400	500	88	0	12	Cons. Durables	Tyco
GUY ELLIFFE Jurika & Voyles	9800	10386	1166	1900	460	60	20	20	Cons. Staples	Hormel
ROBERT R. REISER Balentine & Co.	9950	10300	1200	2029	490	50	20	10		
JEFFREY SAUT Raymond James		10000	1100	2000	460	65	15	10	Health Care	
ROGER DeBARD iGlobal Capital	9800	9850	1110	1910	425	39	28	33	Financials	Merrill Lynch
BERNIE SCHAEFFER Schaeffer's Investment Research	8000	9000	925	1500	375	20	0	70	Cons. Staples	Krispy Kreme Doughnuts
DDUGLAS CLIGGDDT J.P. Morgan Chase	8000	8500	950	1500	525	50	25	25	Cons. Staples	USX Marathon
GEORGE W. JACOBSEN Trevor Stewart Burton & Jacobsen	7200	8100	1000	1800	425	50	50	0	Cons. Staples	Diebold
JDSEPH H. BARTHEL Fahnestock	10400	8000	920	1500	380	100	0	0	Health Care	DRS Technologies
EDWARD KERSCHNER UBS Warburg			1570			80**	20	0		
AVERAGES	10404	11090	1292	2236	520	70	20	9		

*Asset allocations totaling less than 100% result from allocations to other categories not listed here, such as REITs, gold, and hedge funds

**As of 12/6/01

turn the gurus' consensus forecast into a reality.

All but one of the 38 strategists polled a year ago overestimated where the Dow, S&P 500, and Nasdaq would be at yearend. Long-time bear George Jacobsen of Trevor Stewart Burton & Jacobsen proved the most prescient when his predictions for all three indexes are combined (box).

Technology gets the most votes for the sector destined to perform best in 2002. Because tech stocks rise and fall with the economy, "it's a play on a cyclical recovery," says Alvin S. Mirman, director of research at Boca Raton (Fla.) brokerage vFinance and the strategist who is most bullish on the Dow for 2002. "You'll see a stronger rebound than people expect." Even if the recovery is mild, Kleintop argues, companies will spend on technology because items purchased in the late 1990s are already obsolete.

Others caution that tech stocks—which staged a rally late in 2001—have become too expensive again. Unless the economy roars back, says First

Union's Smyth, "I don't think you can justify valuations that are on the upper end" of the range. Today, tech stocks trade at a price-to-sales ratio 2.5 times the level of the S&P 500 (minus companies with no sales, including banks). That's close to the sector's historical high of three times the index's multiple, Smyth adds. He champions financial stocks, which, along with health care and tech, round out the strategist's top three sector picks. Those who expect a muted recovery are betting on health care, which delivers steady earnings in good times and bad.

As you would expect in a bear market, most—about two-thirds—of last year's individual stock picks lost money. The biggest dog? Enron, the now-bankrupt energy trader. Still, some forecasters made good calls. Take Allan Roness of ASR Corporate Consultants in Boca Raton. His pick, Trust Co. of New Jersey, gained 95.8%. Let's hope more of the strategists got things right in their forecasts for 2002.

THE YEAR OF THE PRESCIENT BEAR

A year ago, the market strategists in *BusinessWeek's* Fearless Forecast predicted modest-to-large gains for the major indexes. Boy, were they wrong. Instead, the group's lone bear, George W. Jacobsen Jr. of New York-based Trevor Stewart Burton & Jacobsen, came out on top with a forecast that looked toward the bottom. Jacobsen was the only one to predict that all three major indexes—the Dow Jones industrial average, the Standard & Poor's 500-stock index, and the Nasdaq Composite—would lose ground in 2001.

Not that he hit the numbers dead on. Jacobsen's 8100 Dow estimate, which looked pretty good in late September, was 19% under where the index finished on Dec. 7, the day *BusinessWeek* called the winner. However, Jacobsen came the closest to pegging the other two major benchmarks, missing the S&P by 13.6% and the Nasdaq by 11%. When his scores on the three indexes were averaged, he was off 14.7%.

The key to his forecasts? A recognition that corporate profits would be squeezed. Jacobsen expected profits to fall 10% in 2001, as low inflation held prices in check. While he underestimated the year's actual profit shortfall by about 6 percentage points, Jacobsen came a lot closer



HIT REPLAY: Jacobsen's 2002 forecast is the same as his winning one for 2001

than his peers, who were looking for profit growth of 7.5%.

Charlie Crane of New York-based Victory SBF Capital Management came closest to pegging the Dow, overestimating its Dec. 7 finish by 7%. And Douglas Cliggott, chief U.S. equity strategist at J.P. Morgan Chase & Co., made a strong

showing. When his forecasts on all three indexes were combined, he overshot by an average of 18%, second overall.

Jacobsen—last year's most bearish forecaster and this year's second-most—remains pessimistic. While many pros are predicting an earnings rebound, Jacobsen thinks profits will continue to languish as strapped corporations defer expenditures. "I don't see an engine for growth. I don't see consumers or businesses with pent-up demand," he says. That's why Jacobsen favors companies that sell consumer staples, such as food and health-care products, which tend to perform well in good times and bad.

Jacobsen wouldn't be surprised to see big sell-offs on disappointing earnings news next year. His forecast for the end of next year—8100 for the Dow, 1000 for the S&P, and 1800 for the Nasdaq—is unchanged from the one that garnered him top honors this year. Still, this strategist, who turned cautious on stocks in 1997, looks for bargains to emerge during the year and for a modest recovery. Who knows? By this time next year, the longtime bear may turn bullish.

By Brian Hindo in New York

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Still a True Believer In Dow 36,000

Co-author Kevin Hassett says values will soar yet



"Folks who took the advice benefited tremendously"

Kevin A. Hassett and co-author James K. Glassman startled the financial world with their 1999 book, *Dow 36,000*. It argued that as investors grew comfortable owning stocks, stocks became less risky, and that once the market adjusted to that lower risk, stocks would be revalued much higher. Senior Writer Robert Barker spoke with Hassett, a resident scholar at the American Enterprise Institute in Washington, on how he sees Dow 36,000 in light of a nasty bear market. Here are edited excerpts:

Were you wrong about the Dow?

No, I don't think so at all. No one said that the market's fluctuations were over. About the time the book came out, we were at Princeton University debating, and one of the professors there said that if after two years of a weak or flat stock market, individuals stayed in stocks and didn't run for the exits, then we would have been proven right. I would argue that, in fact, that test has occurred, and we won.

What about readers who bought stocks on your advice?

Folks who took the advice benefited tremendously. We looked carefully at Old Economy stocks that make money and grow it over time and found that they were undervalued: Johnson & Johnson, General Electric, Coca-Cola, Tootsie Roll, companies like that. Of what we called "36er" stocks in the book, we recently asked the question, how would you have done if you had bought those, as opposed to the Standard & Poor's 500-stock index, and held? And from Sept. 1, 1999, through Oct. 30, 2001, we outperformed the index by 19.4 percentage points. So I think that everything that has intellectual content within the book has broken our way.

Wait, does that mean the title doesn't have "intellectual content"? You foresaw 36,000 on the Dow in three to five years.

Oh, but we were very, very cautious about making people understand that there were no

guarantees in the near term. We also said in the book that the market might drop 30% to 40% in the next couple of years.

Have investors adjusted their view of risk since September 11? If so, what does that mean for stock valuations?

A difficult question. A lot depends on whether we're able to stay on this path of convincing victory. We have, for example, been reading about the terrorists having nuclear material. If we are entering a new world where people are going to explode nuclear bombs in the U.S., then that's going to have a very profound effect on valuations.

A central part in your book's argument was that for a long-term investor, stocks actually are less risky than bonds. Have the terrorist attacks and fears altered that? Didn't they make you want to own bonds more than stocks?

No. And, in fact, right now I think that the risks for nominal bonds, the ones that are not inflation-protected, are exceptionally high. The fact is that we're nearing the end of a recession, in all likelihood. And there's a tremendous amount of monetary stimulus and fiscal stimulus out there. Normally when that happens, inflation takes off like crazy and people who own bonds get creamed.

The market is priced at more than 22 times next year's earnings. You still hold that that's way too low?

The test of the past two years has shown that. We've just had this tremendously bad run of negative surprises, yet the P/E has stayed relatively high. That can only bode well provided that we really do win the war on terrorism.... At 22, it's very easy to see how over the next 10, 15, or 20 years that stocks are going to continue to increase.

Index busters

Hassett claims the "36er" stocks beat the S&P 500 by 19.4 percentage points from Sept. 1, 1999, through Oct. 30, 2001

Any specific advice for individual investors?

If you're going to buy bonds, you should buy Treasury Inflation-Indexed Securities. Be very careful about inflation this year, so think about things that get hurt when inflation takes off and stay away from them.

And stocks?

The view that irrational exuberance was driving the market higher has really been put to rest by recent experience. We've tested people with weak stock returns, and they have stayed in the market. That means the upside for stock prices is significant, provided that earnings growth returns. But I believe very strongly that if you want to benefit from great earnings surprises, then you need to buy stocks that have earnings. So you should be looking at value funds. Or if you're buying stocks, buy blue chips.

BusinessWeek online

For a the complete version of this interview, go to the Dec. 31 issue online at www.businessweek.com

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The Waiting Game

A majority of investors thinks stocks will rise—but that doesn't mean they'll be buying

BY PETER COY

Investors are nervous and confused after a year in which the stock market crashed and then partially recovered. While they're far more likely than last year to think stocks are a good deal at current prices, they're less prone to stepping up their purchases in the coming six months.

These are some of the key findings in the *BusinessWeek/Harris Poll* for the annual Investment Outlook. In the portion of the survey that is asked of the general public—not just stock investors—39% picked real estate as the single

best investment to make now, up from 28% who felt that way last year. Stocks were the No. 1 pick of just 20%, down from 29% a year ago. That's even though 52% of the general public thinks stocks will go up in the coming year, compared with just 33% who felt that way last year.

Stock investors exhibit the same caution as the public at large. Only 28% say they'll invest more in stocks and mutual funds in the next half-year, down from 42% who said so in 2000. That's surprisingly cautious, considering that only 33% think stocks are overpriced, down from 51% who thought so in last year's poll.

Stock investors have lowered their sights. Fully 54% expect to earn only single-digit returns from stocks in the long run, vs. just 31% who were so pessimistic as recently as 1997. Yet they haven't totally lost their hubris: 76% are somewhat or very confident that their stock and fund picks will beat the market averages.

Tech stocks look like a better bargain to some investors this year, with 21% calling them somewhat or very cheap, vs. only 7% who thought so last year. (To be sure, 46% still think they're overpriced.) International stocks are still a black box: Fully 47% venture no opinion on them at all.

This year, we asked a special question of all respondents, not just stock investors, about how they thought "terrorism and the war against it" would affect the stock market in the coming year. People were evenly split, with 39% predicting a favorable effect and 40% an unfavorable one.



BEST INVESTMENT

If you had to choose the one investment that you think would be the best to make right now, which would it be?

	1989	1998	1999	2000	2001
Real estate	40%	30%	30%	28%	39%
Mutual funds	8%	18%	20%	21%	13%
Bank or S&L deposits	8%	11%	12%	14%	7%
Common stock	5%	13%	13%	8%	7%
Money-market funds	11%	7%	7%	8%	5%
Gold, other precious metals	8%	4%	5%	4%	5%
Government bonds	15%	5%	5%	5%	8%
Corporate bonds	3%	3%	2%	1%	3%
Don't save/Not sure/					
No answer	2%	9%	5%	10%	13%

WHERE'S YOUR MONEY?

Thinking about your household's total assets including real estate, stocks (including stock mutual funds), bonds (including bond mutual funds), savings instruments, and cash, does your household own any of the following?

		YES	NO	NOT SURE/ NO ANSWER
Real estate	2000	59%	32%	9%
	2001	60%	37%	3%
Stocks	2000	47%	42%	11%
	2001	47%	49%	3%
Bonds	2000	27%	61%	13%
	2001	26%	69%	4%
Savings instruments and cash	2000	67%	21%	12%
	2001	72%	25%	2%
Some other asset	2000	34%	55%	12%
	2001	34%	62%	5%

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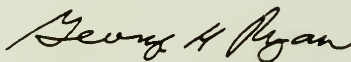
The most recent addition to our corporate community, The Boeing Company, embodies the spirit of the Illinois economy. Illinois, like Boeing, is constantly looking to support the development of new innovations that will improve our ability to do business and enhance our quality of life.

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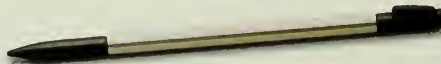
We are proud of these visionaries who call Illinois home. Their presence continues to make this state one of the most desirable corporate climates in America. I encourage you to learn more about what Illinois can offer your business as you position your company to be more competitive in the global economy.

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George H. Ryan
Governor



George H. Ryan, Governor
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BULLS OR BEARS?

Over the next year, do you think stocks will go up, stay about the same, or go down?

	1989	1998	1999	2000	2001
Go up.....	39%	37%	52%	33%	52%
Stay about the same.....	38%	34%	20%	26%	25%
Go down.....	16%	21%	17%	23%	14%
Not sure/No answer.....	7%	8%	10%	18%	10%

A CRASH COMING?

Over the next 12 months, how would you rate the chance of another big crash in the stock market—very likely, somewhat likely, not very likely, or not at all likely?

	1989	1998	1999	2000	2001
Very likely.....	13%	14%	15%	13%	14%
Somewhat likely.....	43%	41%	37%	37%	38%
Not very likely.....	31%	29%	33%	35%	32%
Not likely at all.....	10%	11%	11%	7%	11%
Not sure/No answer.....	3%	4%	4%	8%	5%

THE WAR ON TERRORISM

How do you think terrorism and the war against Iraq will affect the stock market over the next 12 months—very positively, somewhat positively, somewhat negatively, very negatively, or will have no effect at all?

Very positively.....	11%	Very negatively.....	8%
Somewhat positively.....	28%	No effect at all.....	14%
Somewhat negatively.....	32%	Not sure/No answer.....	7%

REMAINING QUESTIONS ASKED ONLY OF STOCK INVESTORS

BOUGHT STOCKS LATELY?

Have you bought common stock or shares in a stock mutual fund within the past year?

	1999	2000	2001
Have bought.....	57%	59%	53%
Have not bought.....	42%	39%	46%
Not sure/No answer.....	1%	2%	1%

STOCK-BUYING PLANS

Over the next six months, do you think you will probably invest a lot more in stocks or stock mutual funds, invest somewhat more in stocks or stock mutual funds, reduce your investment in stocks or stock mutual funds somewhat, or reduce your investments a lot?

	1999	2000	2001
Invest a lot more.....	10%	7%	4%
Invest somewhat more.....	37%	35%	24%
Reduce somewhat.....	10%	13%	15%
Reduce a lot.....	5%	5%	9%
Stay the same.....	29%	32%	42%
Don't invest/Not sure/No answer.....	10%	7%	6%

WHAT CAN YOU EXPECT FROM STOCKS?

In the long run, what sort of total returns (capital gains plus dividends) do you expect the stock market to produce for you—below 5% a year, 5% to below 10% a year, 10% to below 12% a year, 12% to below 15% a year, or 15% or higher a year?

	1997	1998	1999	2000	2001
Below 5% a year.....	4%	9%	7%	7%	12%
5% to below 10% a year.....	27%	26%	30%	33%	42%
10% to below 12% a year.....	30%	29%	27%	25%	24%
12% to below 15% a year.....	19%	18%	14%	12%	9%
15% or higher a year.....	14%	17%	13%	12%	7%
Not sure/No answer.....	5%	2%	10%	11%	7%

THINK YOU CAN BEAT THE MARKET?

How confident are you that the stocks or mutual funds you pick will beat the market averages—very confident, somewhat confident, not very confident, or not at all confident?

	2000	2001
Very confident.....	17%	14%
Somewhat confident.....	62%	62%
Not very confident.....	12%	14%
Not at all confident.....	3%	5%
Not sure/No answer.....	6%	4%

VALUATION OF STOCKS OVERALL

Overall, how would you describe the stock market's valuation—very overpriced, somewhat overpriced, fairly valued, somewhat cheap, or very cheap?

	1999	2000	2001
Very overpriced.....	12%	11%	4%
Somewhat overpriced.....	46%	40%	29%
Fairly valued.....	31%	28%	39%
Somewhat cheap.....	4%	9%	17%
Very cheap.....	*	1%	3%
Not sure/No answer.....	7%	11%	8%

VALUATION OF INTERNATIONAL STOCKS

Overall, how would you describe the valuation of international stocks—very overpriced, somewhat overpriced, fairly valued, somewhat cheap, or very cheap?

	1999	2000	2001
Very overpriced.....	6%	7%	5%
Somewhat overpriced.....	22%	23%	18%
Fairly valued.....	19%	17%	21%
Somewhat cheap.....	11%	10%	8%
Very cheap.....	1%	2%	2%
Not sure/No answer.....	41%	41%	47%

VALUATION OF TECHNOLOGY STOCKS

Overall, how would you describe the valuation of technology stocks—very overpriced, somewhat overpriced, fairly valued, somewhat cheap, or very cheap?

	2000	2001
Very overpriced.....	18%	15%
Somewhat overpriced.....	35%	31%
Fairly valued.....	19%	22%
Somewhat cheap.....	6%	17%
Very cheap.....	1%	4%
Not sure/No answer.....	21%	11%

VOLATILITY

Do you believe that next year, the stock market will be less volatile, about as volatile as this year, or more volatile?

	1998	1999	2000	2001
Less volatile.....	16%	11%	24%	42%
About as volatile as this year.....	56%	54%	43%	40%
More volatile.....	26%	28%	24%	12%
Not sure/No answer.....	2%	7%	10%	6%

This survey of 1,006 adults, including 565 stock investors, was conducted from Nov. 30 to Dec. 3, 2001, for *BusinessWeek* by Harris Interactive Inc. The margin of error for stock investor responses is plus or minus 4%. For more results, see the Dec. 31/Jan. 7 issue online at www.businessweek.com.

Despite expecting an upward trend in the market, 54% of investors foresee single-digit returns

Some Races Are Not to the Swift

Many dividend-payers offer rising income streams

BY MARGARET POPPER

From 1995 to 2000, dividends looked as if they were going the way of poodle skirts and pompadours. Fast-growing companies plowed their money back into the enterprise and rewarded their investors with more growth. Who could complain? Share prices were rising by 20% a year and more.

Small wonder investors forgot about dividend-paying stocks. "A company pays high dividends because its growth prospects have cooled and it can't think of anything better to do with the money," observes Steven J. Lehman, a portfolio manager at Federated Investors Inc.

With the cratering of such late-'90s growth-stock stars as Cisco Systems, Qualcomm, and JDS Uniphase, dividend-paying stocks are back in style. For starters, with short-term interest rates at 40-year lows, even a 2% dividend looks pretty generous. And investors have learned that in a bear market, a dividend from a solid company is one return you can count on. Indeed, according to a study by T. Rowe Price Associates, in the year 2000 the prices of dividend-paying equities in the Standard & Poor's 500-stock index rose an average of 3.1%; those that paid no dividends dropped by 39.2%. If nothing else, a company with a good track record on paying and increasing dividends probably is one with a good earnings history as well.

Consider the return from high-dividend stocks. The share prices for Philip Morris Cos. is up 4% so far this year, but dividends have added an additional 5% to its overall return. Procter & Gamble Co. is up just 2%, but with its dividend the total return is 4%. Meanwhile, the S&P 500 lost 15% of its value so far this year and yielded just 1.3% in dividends.

In the current market, some dividend-paying stocks are even competitive with traditional growth stocks (table). Take banking giant J.P. Morgan Chase & Co. It has a hefty 3.6% dividend yield and a history of increasing its payout 13% a year. Next, consider Tyco International Ltd., a conglomerate with an aggressive growth strategy. Tyco pays only a token dividend that it has never increased.

A few years ago, no one would have disputed that Tyco would provide a better total return to shareholders than a big bank. But take a look at the new math. As long as you reinvest the dividends in J.P. Morgan Chase stock, we estimate that in five years, the investment would be worth more than a comparable amount of money put in Tyco on a pretax basis. Since taxes on dividends are higher than on long-term capital gains, dividend stocks are less attractive in taxable accounts. But they work just fine in IRAs and other tax-deferred vehicles.

Our analysis makes several assumptions about dividend growth, earnings growth, and stock price appreciation. For dividends, we used the company's historic growth rate. For earnings we used the five-year growth projected by Wa-



reet analysts, which we then sliced by a third, nce they're always too high. We then assumed at the stock price would appreciate in line ith earnings.

Bank stocks, such as Bank of America, J.P. organ Chase, and Wells Fargo, are always good aces to hunt for dividends. So are oil stocks age 88). You also can get yield and modest owth from food and tobacco stocks. R.J. eynolds Tobacco has an eye-popping 5.6% divi- end yield. Price appreciation is likely to be slight, nce analysts forecast only 10% earnings growth 2002. If the stock goes up only 5%, the total re- rn still reaches over 10%. Not bad for a low- volatility stock with a solid balance sheet.

For a clever play among the traditional high- elders—utility stocks—consider TXU Corp. The allas-based power company boasts a 5.3% divi- end yield and a history of growing it by 3.3% ch year. "Its yield is high because it is a major ayer in gas, and that's a good story, longer- rm," says David Gilmore, a portfolio manager Federated Investors. Add that to the potential r 6% stock appreciation, and you've got a 12% verall return.

If you're still bent on buying growth stocks, dividends can offer a signpost to bargains. So-called "fallen-angel growth stocks" are former high- fliers whose dividend yields are un- usually high simply because their share price has fallen. "By the time their dividend yields are 25% high- er than the market's [dividend yield], the bad news has already been priced into the stock," ob- serves Nancy Tengler, CEO of San Francisco-based Fremont Funds. So the shares are likely to go up, and

You Can Count on Them

High-dividend stocks that should keep on yielding

STOCK/ SYMBOL	PRICE*	DIVIDEND YIELD	DIVIDEND GROWTH RATE**
TXU TXU	\$44.59	5.3%	3%
UST UST	34.49	5.2	9
PHILIP MORRIS MO	45.81	4.7	8
GENERAL MOTORS GM	47.48	4.2	9
CONAGRA CAG	23.78	3.8	13
BANK OF AMERICA BAC	61.42	3.6	13
WELLS FARGO WFC	42.67	2.2	13
GENERAL ELECTRIC GE	37.81	1.7	15

*As of Dec. 14 **Based on historic growth rate Data: BusinessWeek, Thomson Financial/First Call

you will be getting paid to watch them rise.

Several examples of fallen angels can be found among the major drug companies. During 2001, Bristol-Myers Squibb Co. and Merck & Co. saw their stock prices drop 32% and 38%, respectively, and both stocks yield around 2%. If you believe analysts' growth projections, both stocks could be up by about 8% in the next year. You would collect 2% in cash while you're waiting.

Of course, buying stocks purely on dividend yield is not smart. "Companies like AT&T, Motorola, and Nortel became high-yielding stocks just before they cut their dividends," points out Thomas J. Huber, portfolio manager of the T. Rowe Price Dividend Growth Fund. The dividends are so high mainly because the companies have serious problems and the stock has been clobbered. And sometimes the market knocks down the troubled stocks when it expects a dividend cut.

Companies with a history of paying dividends are, at the very least, a sensible place to park your cash—and quite possibly a moneymaking opportunity in a market where few are in sight. ■

Income vs. Growth Stocks? It's Closer Than You Think

As long as you reinvest the dividends, income stocks can deliver returns competitive with growth stocks. The following example compares what you'd get by investing \$10,000 in a high-dividend stock, the banking giant J.P. Morgan Chase, and Tyco International, a growth-oriented conglomerate with only a token dividend. We used the company's current dividend to estimate the dividend yield for the first year and historical dividend payout trends to estimate how fast their dividends will grow. For stock price appreciation, we assumed stock prices would grow at two-thirds of the Wall Street analysts' five-year estimated earnings growth rate.

J.P. MORGAN CHASE*	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
VALUE OF STOCK REINVESTING DIVIDEND	\$10,000	\$11,189	\$12,575	\$14,134	\$15,886
(VALUE OF DIVIDEND BEFORE REINVESTING)	360	455	512	575	646

TYCO INTERNATIONAL**	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
VALUE OF STOCK REINVESTING DIVIDEND	10,000	11,200	12,544	14,049	15,735
(VALUE OF DIVIDEND BEFORE REINVESTING)	5	6	6	7	8

BY THE FIFTH YEAR, THE TOTAL VALUE OF THE J.P. MORGAN CHASE INVESTMENT WOULD EXCEED THAT IN TYCO INTERNATIONAL

*3.6% current dividend yield; 13.0% annual dividend growth; 8.0% annual capital appreciation

**0.05% current dividend yield; 0% annual dividend growth; 12% annual capital appreciation

Data: BusinessWeek, Thomson Financial/First Call

A Comeback For the Oil Patch?

Some managers see prices bouncing back

BY CHRISTOPHER
PALMERI

Remember the energy crisis? Just a few months ago it seemed the world was running out of fuel. Now, energy trading juggernaut Enron Corp. is bankrupt, gasoline sells for under \$1 a gallon in many markets, and a barrel of crude trades for \$19, down 40% from a year ago. It sounds like a better time to buy a gas-guzzling SUV than Exxon Mobil Corp. stock.

But some money managers say energy is the place to be in 2002. That's because recent declines in commodity prices are already reflected in energy stocks: Those in the Standard & Poor's 500-stock index are down an average of 17.9% since the start of 2001. "We recognize that current earnings are not good, but we think prices have bottomed," James P. Coughlin, manager of the \$250 million Enterprise Growth & Income Fund. "The economy is not falling off a cliff. Supply and demand will come into balance."

Energy now makes up 14% of Coughlin's fund assets, vs. 6% for the S&P 500, according to fund tracker Lipper Inc. Coughlin's move is part of a broader strategy to take advantage of

the U.S. economic recovery he believes is coming in 2002. For now, he's sticking with conservative names such as Exxon Mobil, Royal Dutch/Shell Group, ChevronTexaco, and BP. The companies are trading at steep discounts to the market and generating much higher dividend yields. BP, for example, is considered one of the best managed oil companies. It trades at just 15.7 times anticipated 2002 earnings, vs. 21.5 for the overall market. BP

yields 3%, three times the market average. "The group has been out of favor," Coughlin says. "We like to buy cheap."

Mark Regan, manager of the \$1.8 billion MFS MidCap Growth Fund, also believes prices will bounce back, but he is focusing on the U.S. natural gas market. When gas hit \$10 per million British thermal units in late 2000, a lot of power plants and businesses switched to other fuels. With the price much lower now, Regan believes demand will come back. Meanwhile, new supply has been much tougher to find. Regan has large positions in companies such as Devon Energy, Apache, EOG Resources, and Newfield Exploration. But he has been selling drilling rig operators such as Global Marine, Transocean, Sedco Forex, and Diamond Offshore Drilling because he thinks the current price of natural gas—around \$2.50 per million Btus—is discouraging companies from doing any drilling. "Rates for rigs will come down," Regan says. "The price of gas will come

back first."

What if energy prices don't bounce back? James W. Stratton, manager of the \$50 million Stratton Growth Fund, is betting on refiners. "As the price of crude falls, refined products fall as well, but not by as much," Stratton notes. "They benefit from the spread." Stratton likes that refiners like Ultramar Diamond Shamrock Inc., which is in the process of merging with Valero Energy Corp., have been buying back their own shares rather than investing in new capacity. Stratton also owns USX Marathon Corp., which will be spun off from USX Corp. on Jan. 1. Stratton thinks Marathon's strong exploration and refining businesses make it a takeover candidate. "My sense is they won't stay independent long," he says.

The beleaguered energy-trading industry is also ripe for consolidation, says Raymond Jamison & Associates energy analyst Fred Schult. Larger, more diversified companies such as Duke Energy and El Paso Energy could acquire the likes of Mirant. "Anyone with natural gas assets will be looking for power assets," he says. But whether you are an acquisition-minded CEO or just an investor, the best time to go shopping in the energy sector is when prices are low.

Oil Patch Buys

STOCK/SYMBOL	PRICE*	P/E**
BP BP	\$44	16
One of best managed majors		
CHEVRONTEXACO CVX	84	18
Recent merger is producing big cost savings		
APACHE APA	48	15
Savvy acquirer of oil and gas properties		
EOG RESOURCES EOG	36	39
Large natural gas reserves		
EL PASO ENERGY EPN	35	52
Broadening its reach in the power business		
USX-MARATHON MRO	28	11
Potential takeover target		

*As of Dec. 14 **Estimated 2002 earnings Data: Analyst survey, Múltex



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REITs Can Be a Roof Over Your Head

They offer outsize dividends even in a recession

BY
MICHAEL ARNDT

Can real estate investment trusts (REITs) pull off a hat trick? They delivered an impressive total return of 29% in 2000 and a solid 11.5% in 2001, a period when the stock market was in a dive and the economy was sliding into a recession. Sure, vacancy rates are up and rents down, but REIT investors believe they will make money again in 2002.

What's most attractive about REITs, which are real estate holding companies, is their outsized dividends. Required by law to distribute at least 90% of their taxable income to shareholders, REITs boast an average yield of 7.5%. That's five times the dividend yield on the Standard & Poor's 500-stock index and far ahead of high-quality bonds, certificates of deposit, and money-market funds, which weren't paying even a third as much at yearend.

With that 7.5% head start, all it takes is 2.5 percentage points in share-price appreciation for REITs to hit double-digit returns again. And analysts and fund managers believe shares should go up by at least that much, no matter what happens to the overall market. For one thing, REITs have shown that they can prosper even in a recession.

What if other stock sectors rebound on an economic recovery? Granted, that could lure some investors away, just as the tech stock boom put REITs in the doghouse a few years ago. But analysts point out that landlords should profit from a

resurgent economy, too, since they would be able to attract more tenants at higher rents. And fortunately for REITs, there's not too many new buildings opening in 2002. Lenders have been loathe to finance buildings unless builders had lined up tenants first. The bottom line: REITs, on average, should produce a 12% total return in 2002, says Keith R. Pauley, managing director of LaSalle Investment Management.

Today's best bets, say the pros, are industry leaders such as Equity Office Properties Trust. They have top-notch management teams, strong balance sheets, and such geographically diversified portfolios that they can weather downturns handily, whether it's the burst dot-com bubble in San Francisco or the blow from terrorism in Manhattan. Although new-lease rents are down from 2000's peak across the U.S., Equity Office Properties, for instance, was still raising rents by an average of \$4.50 per square foot in late 2001. How's that possible? Tenants whose

leases are up for renewal typically have been paying rates set 18 months or more years ago. Even today's lower rents are higher than they were back then.

Although some retailers are hurting, analysts still see value in shopping-center REITs. Analysts Steve Sakwa of Merrill Lynch & Co. and Jonathan Litt of Simon Smith Barney like Simon Property Group. The largest owner of regional shopping malls, Simon has 90.6% of its space occupied, thanks to long-term leases. The two also recommend Vornado Real Estate Trust, which complements its collection of office towers with retail properties and wholesale sites such as Chicago's Merchandise Mart. And Sakwa likes Kinco Realty Corp., the king of s

permarket-anchored shopping centers.

There are REITs to avoid. Because they rely almost entirely on annual leases, residential property REITs will lag the industry in early 2002, as hard times depress demand for apartments. The hotel sector is also getting walloped by the post-September 11 drop in travel. Indeed, Host Marriott Corp. suspended its common dividend Dec. 5. Analysts also urge investors to stay away from National Golf Properties Inc., which has warned that its largest tenant may not be able to pay its rent through the winter.

But for every National Golf, there is a Capital Automotive REIT. A favorite of analyst Lawrence D. Raiman of Credit Suisse First Boston, Capital Automotive owns 260 car lots, which it leases to dealers under long-term contracts. The REIT has hiked its dividend 15 quarters in a row and now yields a bountiful 8.2%. That's a payout most any investor can appreciate.



Shelter From The Storm

STOCK/SYMBOL		PRICE*	YIELD*
CAPITAL AUTOMOTIVE REIT	CARS	\$19.06	8.2%
SIMON PROPERTY GROUP	SPG	29.44	7.1
EQUITY OFFICE PROPERTIES	EOP	29.33	6.9
VORNADO REALTY TRUST	VNO	40.45	6.6
KIMCO REALTY	KIM	49.69	6.3

*As of Dec 14

Data: Bloomberg Financial Markets



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Watch Your Step with Wall Street Stocks

Their earnings may not meet analysts' expectations

BY EMILY THORNTON

The Federal Reserve has cut short-term interest rates below 2% for the first time in 40 years. Investment banks are rolling out corporate bonds at record speed. Multibillion-dollar initial public offerings of big names such as Prudential are back in vogue. And financial-services firms have escaped Enron Corp.'s collapse relatively unscathed—so far. Is it time to sink your spare cash into Wall Street stocks?

Tread carefully. After posting dismal earnings for the fourth quarter, analysts expect brokers' earnings to drop 7% in 2001 and then jump 19% in 2002, vs. a 15.5% rise in the earnings of Standard & Poor's 500-stock index companies, according to Thomson Financial/First Call. But that assumes the economy will rebound by mid-2002. "If we get back into a recovery, brokerage stocks probably make sense," says First Call research director Charles L. Hill. "But if you're worried there is too much optimism in the economy, then all bets are off. This is a fairly high-risk situation."

Too much optimism may still be embedded in many

securities firms' valuations. Trading at 14.2 times 2002 earnings, vs. their historical average 13.9, brokers command a slight premium, says Goldman, Sachs & Co. analyst Richard Strauss. Yet Amy Butte, analyst at Bear, Stearns & Co., cautions that brokers may have to get by on a lot less business, slash their head count by 12.5% from their levels at the start of 2000, and make do with a 15% return on equity, vs. an average of 18% during the past two decades. "Investors have to be careful that the earnings growth expectations are in line with valuations," Butte says.

Investors with iron nerves should check out those securities firms better positioned for a downturn than may be recognized. Henry McVey, analyst at Morgan Stanley Dean Witter & Co., likes Lehman Brothers Inc. partly because it is trading at a discount to many of its peers. "Lehman has built a sturdier equity franchise than most investors perceive," says McVey.

Big believers in diversification should look at Citigroup. It is the only financial services firm that analysts agree has truly cracked the code on selling advice on everything from potential merger partners to insurance. Yet its stock price is trading at only 14.2 times estimated 2002 earnings, vs. its historical average of 18.3.

Another way to navigate the sector is to stick with players who dominate higher-margin businesses such as investment banking. Goldman Sachs and Morgan Stanley have been particularly hard-hit by the drought in lucrative equity underwriting and mergers in 2001. But by the same token, when the economy picks up, they could rebound most sharply.

Really gutsy investors might want to take a chance on Merrill Lynch & Co.'s turnaround. Right now, Merrill is making a painful overhaul of its operations, reducing its head count by as much as 15%. It's not yet clear whether those cuts will enrich Merrill's franchise. Still, some analysts are placing their faith in Merrill Lynch President Stan O'Neal to reengineer the brokerage correctly. If that happens, present weak expectations could be replaced by windfall profits. With the combination of cost savings and potential improvement in the brokerage business over the next 12 to 18 months, "you could have something quite powerful in terms of im-

provement in return on equity and margins," says George Moszkowski, financial services analyst at the Salomon Smith Barney unit of Citigroup.

Longer term, some securities firms are selling at attractive prices. But the harsh new reality of slower growth for an industry facing a potential shakeout has not yet been fully reflected in many firms' prices. Investors who plunge in now should realize it could be awhile until they see a return.





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It Could Be Tech Time Again

A few sectors look good—provided you don't overpay

BY GEOFFREY
SMITH

Forgive Roland W. Gillis for sounding relieved. For the past 18 painful months, the co-manager of \$6 billion at Putnam Investments Inc. has watched his technology portfolio slide down, down, down. But, says Gillis, the worst is finally over. "We're not going back to the crazy days," he says, "but we are going back to more normalized growth for technology."

No doubt about it, investors are feeling bullish about tech again, after an 18-month bear market that sliced 72% off the tech-heavy Nasdaq stock

index. Since its low on Sept. 21, the index has soared 37% through Dec. 14. This powerful rally has lifted such heavyweights as Cisco Systems and Oracle by 73% and 43%, respectively, while smaller stocks such as Palm and chipmaker Silicon Laboratories have doubled or tripled.

Prospects that an improving economy—and higher defense spending—will boost tech profits are driving the renewed enthusiasm. Wall Street analysts, notorious for hyping tech stocks, are forecasting 44% earnings rebound in 2002, after a 62% decline according to Thomson Financial/First Call.

How realistic are the being? After all, the Federal Reserve's 11 interest-rate cuts in 2000 haven't yet fueled much capital spending. And big swaths of tech land remain in the dumps as PC makers and cell-phone, telecom, and network-infrastructure companies continue to struggle with overcapacity or market saturation. Plus, many observers think the surge is overdone and expect a sharp retreat before mid-2002. "People are closing their eyes and buying without regard to valuation," warns Paul H. Wick, manager of the \$6 billion Seligman Communications & Information Fund. "They haven't learned anything from the bubble."

Gerald R. Jordan Jr., who manages more than \$1 billion in hedge funds at Hellman Jordan Management Co. in Boston, thinks tech is in a new bubble that will pop at the end of March. After September 11, Jordan put 35% of his assets in software stocks because he thought they were sharply undervalued. He bought Amazon.com Inc. and Siebel Systems Inc., figuring that "they were at the bottom of their cycle and the economy will improve faster than most people think next year." Both stocks have since doubled off their Oct. 1 lows. Other favorites also have risen. Cisco, for one, was bargained in September, at \$11 a share, or 37 times estimated 2002 earnings, says Kevin M. Landis, manager of the \$1 billion Firsthand Technology Value Fund. But at \$19, or 65 times earnings, it's too pricey.

The pros who are buying are looking at tech sectors that remain healthy. Sales of corporate software that increases security or cuts costs continue to grow, and certain consumer categories, such as game consoles, flat-panel displays and digital cameras, are hot—driven by new products or lower prices. So big investors are focusing on software, semiconductors, IT services and outsourcing companies they think can sid-

tech's worst problems and produce healthy profit or revenue rebounds in the coming year. Blue chips, such as Microsoft Corp. and IBM, will have their fans, of course. But the pros are mostly looking for buys among niche companies. The market is going to increasingly focus on small- and mid-cap names, to the detriment of "big names," says Gillis, because in a slow-growing economy, the math works in their favor. Simply put, smaller companies show higher percentage growth rates for every added dollar of revenue. For example, Seligman's Wick likes Peregrine Systems Inc., which makes low-cost help-desk and asset-tracking software. At 30 times Wall Street's estimates for 2002 earnings, it's not dirt-cheap. But Wick expects revenues to rise at a 10% pace in the next few years. "In a period of trenchment in corporate spending, they're less likely to be severely impacted by cutbacks than someone with more expensive software," he says. Landis, at Firsthand, is investing defensively. He bought a big stake in Raytheon Co. after September 11. His logic: Raytheon, the leader in defense electronics, is a likely beneficiary of increased U.S. military spending. But Landis also is focusing on niche markets where he expects decent growth next year. He thinks advanced MA cell-phone handsets, such as those sold by Verizon Communications, will be popular next year, so he has invested in companies that make components for them, including Anadigics and Magato Systems. While both companies are expected to lose money next year, their losses will decrease, and revenues are expected to grow 10% and 14%, respectively, according to analysts' estimates.

FOR
THE
RECORD

Wick runs the \$6 million
Seligman Communications &
Information Fund, which is up 0.9%
through Dec. 14



PAUL H. WICK
Manager, Seligman
Communications Fund

ON THE TECH RALLY In prior downturns, particularly in technology stocks, whenever business has bottomed out, it has been an opportune time to jump back in. But things haven't changed so much: The market runup is overdone. There will be a correction shortly, and it could be very severe.

ON VALUATIONS People are closing their eyes and buying without regard to valuation. They haven't learned anything from the bubble. Broadcom Corp. has gone from \$150 to \$40, but it's trading at 14.3 times revenues. Anytime you get above five or six times revenues, it starts getting risky—unless you have a bulletproof franchise, such as Microsoft Corp. or IBM. Investors have got to do the math.

"The runup is overdone"

Other managers are trying to capitalize on the telecom bust by investing in contract manufacturers. Putnam's Gillis likes Sanmina Corp. and Flextronics International Ltd., both up sharply since September because they are getting manufacturing jobs that telecom companies can no longer afford to do themselves. Sanmina's profits are expected to rise 28% next year and Flextronics' 13%.

Gillis also likes storage-software companies QLogic Corp. and Brocade Communications Systems Inc., which have both nearly tripled since September. QLogic trades at 59 times consensus estimates for 2002 earnings and Brocade at 102 times. But Gillis thinks earnings of both companies will come in higher than expected. "In the same way analysts were too slow to mark down earnings going into the recession," Gillis says, "they will be too slow to raise them coming out of it."

For now, though, the numbers don't favor short-term bulls. Tech valuations soared to 55 times trailing earnings through Dec. 7, according to Leuthold Group, a market researcher in Minneapolis. Considering that tech stocks normally trade at about 33 times earnings, there's a good chance they will dive again. Meantime, hedge-fund managers have huge short positions in tech stocks they expect to fall, such as Sun Microsystems Inc. and Intel Corp.

In the fourth quarter, many investors have become more afraid of losing out on a big rebound than of overpaying for technology stocks. That lack of caution could cost them big in the coming months, if the pes-

A Profit Surge for Some Techs?

COMPANY/Symbol	PRICE*	P/E**
HECKPOINT SOFTWARE CKP Security-software supplier should have 15%-plus profit gain in '02	13	17
PEREGRINE SYSTEMS PRGN Software house should beat '02 earnings estimates	16	37
SANMINA-SCI SANM Outsourcing manufacturer is seeing big business from telecoms	22	32
STUNGARD DATA SDS Disaster-recovery business should spur 23% profit growth	28	26
SYNOPSYS SNPS Chip-design automation company profits could jump 50%	59	27
QLOGIC QLGC 2002 profit surprise expected at storage-software maker	52	58
ORAN ZRAN Chipmaker for DVD players and digital cameras may double profits next year	34	41

As of Dec. 14 **Based on estimated 2002 earnings
Data: Analyst survey, Bloomberg Financial Markets



Good Ways To Dodge the Dangers

Hedging against a stock tumble can hike total returns

BY LEWIS BRAHAM

It's an old dilemma. In a recession, as we're in now, you want to load your portfolio with money-market funds and high-quality bonds that afford some defense against falling stock prices. But if you invest too heavily in these assets, you run the risk of not achieving your financial goals, especially because bond yields are so low. If inflation came back, those bonds would be toxic.

Don't give up entirely on bonds and money funds as risk-reduction tools. But you should also consider specialized mutual funds that can help reduce portfolio risk while improving long-

term returns. Some invest in mergers, while others ride the commodities markets, trade stock options, or even sell stocks short.

You might, for instance, shift some money into the Merger Fund or Arbitrage Fund (BWA Dec. 17). These funds play the merger and-acquisitions game, buying stock in the target company and selling shares to the buyer. Their returns depend not on earnings reports or new products but solely on whether announced deals are completed. The Merger Fund, the oldest arb fund, has delivered a 10.8% annualized return over the past 10 years, besting the average bond fund's 7.0% return with a comparable level of volatility.

Another approach is to invest in a vehicle such as Gateway Fund, which employs a "covered call" strategy. The fund sells call options on the stocks in the Standard Poor's 500-stock index, giving buyers the right to purchase its stocks if the price rises to a predetermined price by a specified date. In return, Gateway collects a call premium, which produces an 18% to 20% annualized income flow for the fund. Then, the fund uses some of that income to buy put options, gaining some downside protection. The results have been a 9.1% annualized return over years with low volatility. Also, since option premiums go up when interest rates rise, the fund moves in the opposite direction from bonds, making it a good portfolio diversifier.

Then there's the "long-short" fund, which, in theory, at least, can make money in any kind of market. Like most mutual funds, it owns stocks—that's the "long" part. But unlike most funds, these vehicles can sell stocks short. That allows them to prosper as prices tumble. Boston Partners Long-Short Equity Fund has delivered a 21.6% return this year because manager Edmund D. Kellogg shorts stocks with high price-to-book values and weak balance sheets and buys those with low price-to-book values and strong financials. The smart strategy is to use these funds to balance out your other equity holdings. So if you own a growth-stock portfolio, throw in a 10% position in a value-oriented long-short fund. Or buy one that emphasizes growth, such as Needham Growth Fund, if your portfolio has a value tilt.

Although we're in a recession, the rate cuts, they take hold, could spark inflation—and neither stocks nor bonds will protect against this risk. Rapidly rising producer prices can put a squeeze on corporate profit margins, causing stocks to decline. At the same time, inflation makes the yields on income-producing investments less attractive. If, say, the inflation rate rises to 6%, and your bonds are yielding 5%, then you are actually losing money on an inflation-adjusted basis.

Three kinds of instruments can help immunize your portfolio against inflation to varying degrees: Treasury Inflation-Indexed Securities,

FUND/SYMBOL	STRATEGY	2001 RETURN*	3-YR ANNUALIZED RETURN*
RECESSION HEDGES			
ARBITRAGE FUND**	Merger Arb.	6.4%	NA%
BDSTON PARTNERS LONG-SHORTEQUITY BPLEX	Long-Short	21.6	17.9
GATEWAY FUND GATEX	Covered Call	-5.1	5.0
MERGER FUND MERFX	Merger Arb.	1.4	12.9
NEEDHAM GROWTH NEEGX	Long-Short	10.2	32.9
UAM ANALYTIC DEFENSIVE EQUITY ANDEX	Covered Call	-4.3	5.2
INFLATION HEDGES			
FRANKLIN FLOATING RATE**	Floating Loans	-3.9	4.5
OPPENHEIMER REAL ASSET QRAAX	Commodities	-31.9	10.1
PIMCO REAL RETURN PRRDX	TIIS	7.8	8.6
VANGUARD INFLATION-PROTECTED SECUR. VIPSX	TIIS	7.1	NA

*2001 and 3-year annualized returns include appreciation plus reinvestment of dividends as of Dec. 14, 2001

**These funds have no ticker symbols. Go to www.theartfund.com or www.franklintempleton.com for more information.

Data: Morningstar Inc. and fund companies

Unlike
most
other
funds,
long-short
funds are
allowed to
sell stocks
short

TIIS), commodity futures, and floating-rate loans. TIIS, which are debt securities issued by the federal government, have the most direct correlation with inflation. In TIIS, the principal rises with increases in the consumer price index (CPI), which tracks prices on goods and services such as food and energy. In addition, TIIS pay out income, ensuring your investment outpaces inflation. "Almost all other asset classes—if inflation goes up, they go down," says Peng Chen, research director at Ibbotson Associates. For this reason, Chen recommends that investors have at least 5% of their portfolio in a TIIS mutual fund. That percentage, he says, could increase in proportion to your dependency on investment income to pay for inflation-sensitive goods such as food and health care. So if you're retired, TIIS could be the majority of your fixed-income portfolio. One caveat: Owning TIIS outright instead of through a fund probably does not pay, because the securities' inflation adjustment is taxable, even though you don't get paid until the bonds mature. TIIS mutual funds, however, do distribute the adjustment to shareholders as regular income.

For long-term investors, a 5% or 10% position in Oppenheimer Real Asset Fund is also a good inflation hedge. By owning a combination of commodity-linked bonds and futures, the fund tracks the Goldman Sachs Commodity Total Return Index, a composite of energy, agriculture, and metals futures prices. Over the past 30 years, this index has delivered a 12% annualized return, compared with 12.8% for stocks. Although volatile by itself, the fund will reduce a portfolio's overall risk, because it performs best when stocks and bonds are down. Indeed, when equities fell 40% in the 1973-74 bear market, commodities were up more than 120%.

Floating-rate loan funds are less volatile than commodities, but not as safe as TIIS. These funds invest in senior secured bank loans, which are of

junk-bond credit quality. Since these loans reset their rates every 40 days or so, they avoid much of the volatility of the bond market. That means if the Federal Reserve raises rates to stifle inflation, these funds won't lose money like a typical bond fund. But interest rates and inflation don't move in lockstep. Indeed, in 2001 the Fed cut rates much faster than the inflation rate fell. So the yields on these funds suffered.

None of these alternatives should replace the pillars of an investment portfolio: stocks, bonds, and cash. But shifting some cash into a TIIS fund and some bonds into an arbitrage or covered-call fund should reduce risk and improve returns over time. Adding a long-short or commodities fund on the margins might give you the extra kick you need to stay ahead of the crowd. ■

FOR
THE
RECORD

Chen's firm is
a Chicago investment
consultancy

ON BONDS AND MONEY FUNDS They are diversification tools, but they're not perfect hedges. Persistently high inflation, such as we saw in the late 1970s and early '80s, can kill cash and bond investors. That's why more people are diversifying into commodities, real estate investment trusts, and other asset classes.

ON TREASURY INFLATION-INDEXED SECURITIES TIIS are expected to provide slightly lower returns than Treasury bonds because you pay a premium to hedge away inflation risk. They should, however, outperform Treasuries when inflation exceeds the bond market's expectations and underperform them when it lags.



PENG CHEN
Research Director
Ibbotson Associates

Put 5% in a TIIS mutual fund

Making Sense of The New Euro World

Europe's currency conversion will create investing opportunities. The question is: Where?

BY DAVID FAIRLAMB

If you liked the uncertainty of European investing in 2001, you'll love 2002. The rally that pushed up Europe's stocks recently could peter out early in 2002 when dismal fourth-quarter earnings are released. An anemic recovery is expected to lag behind any U.S. rebound. And there's a wild card: On Jan. 1, 2002, euro notes and coins will replace those of the 12 euro-zone countries.

A scary picture, yes—but the euro conversion also offers opportunities in Europe for careful investors. Company strategies, buying patterns, and profits will all be affected by the new transparency in European prices. Nobody knows which companies will be winners or losers, but analysts are trying hard to handicap the outcome for major sectors. Many are pushing euro plays as the region's next big investment story. "The euro means we are now able to build competitive global companies," says Jean-Philippe Billot, fund manager at AXA Investment Managers in Paris. "In the long run, the euro will benefit the whole euro-zone economy."

One thing most agree on is that the biggest

impact will be on consumer behavior. Since the euro came into being on Jan. 1, 1999, it has been only a bookkeeping unit. Once Europeans have euros in their wallets, they'll suddenly see how wildly prices vary in the so-called single market—and they'll shop with their feet.

At least in the short term, companies that make big-ticket items such as cars and appliances are vulnerable to margin squeezes, says Brian Hilliard, director of economic research at Société Générale. According to British research firm Taylor Nelson Sofres, nearly half of Europe's large companies believe the euro will hurt profit. Richard Needham, deputy chairman of British Dyson Appliances, expects, for instance, to bring vacuum cleaner prices in expensive Germany in line with those in cheaper Italy. "That is bound to eat into our earnings," he says.

Despite fears that shops are using the euro conversion to raise prices, most will face intense pressure to cut them, especially in border areas. Fund managers also say profits of retailers such as Germany's Kaufhof and France's Pinault Printemps-Redoute could be choked by costs associated with the euro introduction—such as temporary help, training, and security.

But consumers are only part of the euro story. Richard Reid, who heads European equity economics at Schroder Salomon Smith Barney in London, thinks the euro could inspire a revival of mergers and acquisitions, helping not only investment banks but the shares of takeover targets. That's why SSSB analyst Alberto Ponzo thinks Italian utility Italgas' shares, which trade at a discount to other European utilities, will rise strongly. The company is bait for a raider, a cash-rich energy distributor, he says.

The financial sector also could finally see cross-border mergers: Euro notes and coins may help managers and regulators transcend the tendency to protect national champions. At the very least, with only one currency to handle, large financial firms are likely to cut back-office operations. Such expansion-minded banks as UniCredito Italiano and Spain's Banco Bilbao Vizcaya Argentaria have long seen the euro introduction as an opportunity to slash expenses and grow.

The euro won't be the only factor moving European stocks. By the third quarter, the econ-

FOR
THE
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Like most other European equity funds, those managed by Metzler Investment have lost ground this year

ON THE EUROPEAN OUTLOOK Indicators suggest the euro-zone recovery will trail that of the U.S. That's bad for companies with a domestic focus; international ones should do better. A downward correction may come in the first quarter of 2002 when disappointing fourth-quarter [2001] results appear.

ON SECTORS TO BUY Insurance and reinsurance companies look promising: In response to September 11, they are raising premiums. Banks could do well in the second half of 2002 when the economy recovers and loan demand picks up. But the introduction of euro notes and coins will make price comparisons easier, so banking fees could come under pressure.



CARMEN WEBER
Fund Manager
Metzler Investment

Insurers "should recover quickly"



ould gain some steam and investors will be e to look for recovery plays. Banks, which t ground for much of 2001, may outperform ir home markets, as demand for loans and estment-banking services increases. Martin les, an equity strategist at Germany's WestLB nmure, expects the profits of asset managers h as insurance giant Allianz and Swiss finan- conglomerate Credit Suisse Group to surge 2002 because demand for mutual funds, private nsions, and private banking is still growing. rmen Weber, a fund manager at Metzler In- stment in Frankfurt, also likes insurance and nsurance companies such as Munich Re. In

the wake of September 11, she says, "they should recover quickly."

Companies that should do well in the second half of 2002 include industrial equipment suppliers, because their customers buy after a recovery is under way. Especially attractive will be market leaders such as Heidelberger Druckmaschinen, which has 40% of the printing-machinery market, and Italian oil-services group Saipem. Analysts foresee an increase of as much as 30% in Saipem's share price as oil companies, anticipating rising energy use, boost production.

One sector that's expected to rise from the ashes is telecommunications. People are traveling less and using the phone more since September 11, so demand has spiked. Europeans have fallen in love with instant-message services on mobile phones. WestLB Panmure's Gilles says Vodafone Group PLC is well-placed to benefit because of its size and international reach. He predicts a 30% rise in Vodafone's share prices.

Investors should be wary. Europe's tendency to lag behind the U.S. means economic trends that start on the other side of the Atlantic often wane before they gain much momentum on the Continent, trapping investors. Europe's New Economy boom, for example, had a much shorter run than the one in the U.S. Yet the euro is forever. A few good picks early on could offer a long ride.

With bureau reports

The Region's Best Bets

COMPANY/Symbol	COUNTRY	PRICE	P-E
EGON AEG	Netherlands	\$25.44	18
Financial-services firm with solid cross-selling record			
ITALGAS IG IM	Italy	9.13	11
Gas distributor could be takeover bait			
MUNICH RE MUV2 NR	Germany	262.90	30
Insurer will benefit as premiums rise			
NOKIA NOK	Finland	23.67	32
Cell-phone maker spearheads new crop of mobiles			
UBS UBS	Switzerland	51.80	12
Asset manager benefits from conservative strategies			
VODAFONE VOD	Britain	249.70	41
World's largest mobile-phone operator			

ata: Bloomberg Financial Markets, *BusinessWeek*

Wishing on A Few Asian Stars

South Korea and Taiwan will profit from a rebound

BY BRUCE EINHORN

Foreign investors have turned a blind eye to Asia. And for Ajay Kapur, that's a good sign. True, the region's dynamic image has been shattered, admits the regional strategist at Morgan Stanley Dean Witter & Co. in Hong Kong. But, he argues, things looked almost as bleak in the U.S. and Asia in 1992. Yet, in Asia "in 1993 we all made bucketloads of money." Kapur and other Asian analysts are looking for a 2002 repeat performance. Asian inflation is low, corporate balance sheets are improving, and most countries' current accounts are in surplus, Kapur notes. "They are in much better shape than five years ago."

Admittedly, a lot has changed. Most Western investors are disenchanted with emerging markets, while in the mid-1990s they were starry-eyed about their potential. And among the countries many investors have scratched off their list are Indonesia, Malaysia, the Philippines, and Thailand—formerly investment darlings. These countries' politicians and businesses never pushed reforms started after the 1997 financial crisis, and their markets have shriveled. Meanwhile, Japan, once the most dynamic economy in the industrialized world, seems stuck in bad-debt hell.

Still, several Asian nations are likely to get a bounce in the New Year. The big tech producers—South Korea, Taiwan, and Singapore—stand to gain from a U.S. recovery, while China should get a boost from growth in domestic demand.



The top plays are South Korea and Taiwan. Korea's benchmark Kospi index is up more than 40% from its 2001 low of Sept. 17 and is still well off its recent high. While most Asian economies contracted in the third quarter, Korea grew 1.8%. Investors say there has been a sea change in corporate governance. The star is Samsung Electronics Co., the big chipmaker and purveyor of mobile handsets. Despite the downturn, Samsung will land a \$2.4 billion profit this year. "Once the IT industry recovers in the U.S., Samsung will be the first to benefit," says Hwang Chang Joong at LG Securities Co. in Seoul.

Taiwan, which depends more on U.S. demand for its semiconductors and electronics, is an iffy bet. The island's economy contracted by 2.2% in 2001. But its stock market has also rebounded 40% since its post-September 11 low. Chip foundries Taiwan Semiconductor Manufacturing Co. and United Microelectronics Corp. report surprisingly strong sales.

The big risk for Asia remains Japan. Recent statistics are grim. For November, bank lending dropped 4.3% year-on-year, and wholesale prices fell 1.4%. Pressure is rising for the Bank of Japan to weaken the yen sharply in order to boost exports, which would hurt exports from other Asian economies and the U.S. "If the yen keeps falling, then a lot of Korean companies' competitiveness will be badly hurt," says Park Kyung Min, chief executive officer of Hangaram Investment Management Co. in Seoul. The message: Tread carefully in a region that could be full of opportunities—but also unpleasant surprises.

With Brian Bremner in Tokyo and Moon Ihlwan in Seoul

The Region's Top Picks

COMPANY/Country	U.S. PRICE *	P-E RATIO**
GIORDANO INTERNATIONAL Hong Kong Hong Kong clothing retailer is expanding its network across Asia.	\$0.44	11
SK TELECOM South Korea Early investment in next-generation mobile technology is expected to bear fruit as wireless Net use grows.	\$194	17
TPV TECHNOLOGY Hong Kong Producer of LCD terminals for customers like Hewlett-Packard. Tech recovery play.	\$0.31	9
SAMSUNG ELECTRONICS Korea World's largest chipmaker, also makes consumer electronics. Its move into higher-end goods proved a smart one.	\$5.69	9

*As of Dec. 14 **Estimated 2002 earnings Data: Analysts, Bloomberg Financial Markets

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For Lottery Thinkers Only

You'll need a strong stomach for these stocks

BY GARY WEISS

Cynics have long likened playing the stock market to betting on the horses. Recent political and economic spasms have roiled the market, confirming that dismissive point of view. In that spirit, this story will examine some stocks—compiled from suggestions by the *BusinessWeek* staff—that are not for the fainthearted. They are rolls of the dice, if you will—stocks where the risks are huge, but so is the potential for high returns.

A good place to start is with companies that are so unpopular you might think the market is ganging up on them. (No, not Enron Corp.—that would be stretching the idea too far.) Think **Edison International**, the beleaguered California utility. Its stock has barely budged even though state regulators in October allowed the utility to recover from ratepayers all its expenses related to the California power crisis. So one of the largest U.S. utilities—with an ex-

tensive portfolio of power plants around the world—is on sale at half the price of two years ago.

Another battered stock is **Gateway Inc.** The maker has been struggling all year but had better-than-expected Thanksgiving season. If the tech sector rebounds, Gateway could be a takeover target. In the financial sector, **Bear Stearns Cos.** is also widely viewed as takeover fodder. It's heartily disliked by analysts who doubt the firm can make it on its own as the financial services arena becomes even more brutal.

Airlines have burned countless investors. But if you want to take a chance on the industry, try **Amtran Inc.**, parent of American Trans Air, the country's 10th-largest carrier. Its stock is 72% owned by founder and Chairman J. George Mikelsons. Before the terrorist attacks, he had planned to take the airline private. Give Mikelsons time to line up new financing, and he may buy up the rest at a nice premium.

If you ardently believe tech will climb out of the dumps soon, **Conexant Systems Inc.** may be worth a look. It trades at just a fraction of its March, 2000, high, but it recently said sales of chips to wireless customers were higher than expected. Another telecom speculation is equipment maker **ADC Telecommunications Inc.**, which also has seen its stock get beaten down but has none of the debt problems of its rivals.

Investors with really strong constitutions might consider **Palm Inc.** Sure, it's swimming in red ink. But prospects in 2002 are hot for cell phones with built-in personal digital assistants, so Palm could get a boost from software licensing revenues. If Palm survives the recession, it might well thrive. Fiber-optics maker **Corning Inc.** has crumpled along with the telecoms, but it's a huge company with only part of its business in the ailing fiber-optics industry. Down more than 80% since the start of 2001, it now trades at only about 1.4 times book value.

Or you can bet on obscurity. Obscure stocks can turn into little-known money pits, or they can transform your portfolio into a source of enduring pleasure. One high-cholesterol play is **Steak 'N Shake Co.** Based in Indianapolis, the restaurant chain has seen its shares climb 70% in 2001. It has expanded nicely and is packing them in at its counters. If that's not to your taste, you can aim at one of those little niche-within-a-niche companies that either grow handsomely or tank. One such stock is **@Road Inc.**, which sells transmitters for enabling fleet owners to keep track of the trucks, taxis, and so on. Insiders have been buying the stock, always a good sign.

Keep in mind that these plays are "trades"—short-term bets, not core buys and-holds. Sell discipline is a must. If the stocks begin to sour by, say, 10%, don't double down. Dump 'em.

Worth a Gamble?

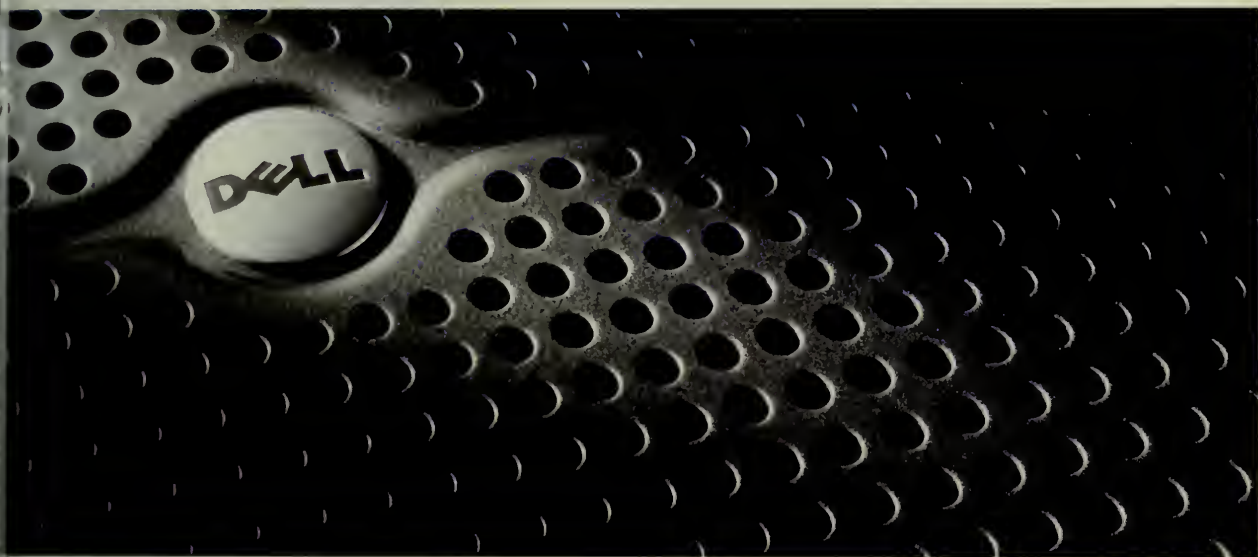
COMPANY/Symbol	PRICE*	P-E RATIO**	COMPANY/Symbol	PRICE*	P-E RATIO**
ADC TELECOMMUNICATIONS ADCT	\$4.99	NA	CORNING GLW	8.74	NA
AMTRAN AMTR	13.51	NA	EDISON INTERNATIONAL EIX	15.20	10.01
@ROAD ARDI	4.57	NA	GATEWAY GTW	8.10	55.35
BEAR STEARNS BSC	56.63	12.7	PALM PALM	3.47	NA
CONEXANT SYSTEMS CNXT	15.86	NA	STEAK N SHAKE SNS	10.70	12.16

*As of Dec. 14

**Based on 2002 earnings estimates

Data: Analysts' survey, Bloomberg Financial Markets, I/B/E/S Inc.

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Send In the New Oracles

A fresh team of stock-pickers steps up to bat

BY CAROL MARIE CROPPER

No doubt about it, the past 12 months have been a debacle for most investors. For the four stock-pickers we asked a year ago to invest a hypothetical \$100,000 in 10 equities, it was humiliating as well. Even Buzz Zaino, whose Royce Opportunity Fund specializes in small-cap value stocks, took a 12.5% hit—and small-cap value was the one bright spot in the market. Still, he had the best results of our four. (Returns were measured from Dec. 8, 2000, to Dec. 14, 2001.)

Zaino attributes much of his losses to problems in the aerospace industry. Suppliers Evans & Sutherland Computer Corp. and Titanium Metals Corp. both plunged after September 11, along with airline stocks. A third aerospace pick, Fansteel Inc., faces a costly cleanup of radioactive residue at an old plant. Its stock has been delisted, and management announced it is considering bankruptcy.

The worst showing came from Maura Shaughnessy, portfolio manager of the MFS Capital Opportunities Fund, which focuses on the opposite end of the investment spectrum from Royce Opportunity: large-cap growth stocks. Shaughnessy's portfolio fell 39.7%, weighed down by troubled telecoms. One pick, XO Communications Inc., had its shares delisted in December after announcing a preliminary deal that would bring much-needed cash but virtually wipe out shareholder equity.

Coming in second and third, respectively, were Walter Price, of the Dresdner RCM Global Technology Fund, and Debby Kuenstner, of the Putnam International Growth & Income Fund. Price's tech portfolio lost 25.5%, perhaps something of a victory considering his sector. Kuenstner's 27.2% loss came in the midst of a growing global recession and a tough market for international stocks. Let's hope our new pickers—and all investors—fare better in '02.

H. Giles Knight

Ark Small-Cap Equity Fund

COMPANY/Symbol	PRICE*
ALLIANCE GAMING ALLY	\$28.72
ALLIANT TECHSYSTEMS ATK	77.24
AXCELIS TECHNOLOGIES ACLS	13.39
CKE RESTAURANTS CKR	8.00
KULICKE & SOFFA INDUSTRIES KLIC	17.07
PRIDE INTERNATIONAL PDE	13.85
PSS WORLD MEDICAL PSSJ	8.85
SKYWEST SKYW	25.36
TELEDYNE TECHNOLOGIES TDY	15.52
XM SATELLITE RADIO XMSR	16.24

*Dec. 14

Data: Bloomberg Financial Markets

Small-Cap Picks That Could Lead the Way

The past year hasn't been kind to small-cap growth investors like H. Giles Knight, portfolio manager of Ark Small-Cap Equity Fund. It's down 9.9% through Dec. 14, though its five-year risk-adjusted return merits an A from the *BusinessWeek* Mutual Fund Scoreboard. Knight looks for the economy to recover in 2002 as small-cap stocks—growth as well as value—assume their traditional role of leading the way.

Knight searches for companies with market caps from \$50 million to \$1.8 billion. Then he pares the list to those with revenues growing minimum of 15% a year, earnings at least 12% plus a return on equity of 15% or more. He weeds out those with debt that's more than 30% of capital. He then sizes up management.

Of Knight's 10 picks, two are in the semicon-



KNIGHT: *One chip play is his "canary in the coal mine"*

ductor industry—usually the earliest beneficiary of increased tech spending. In fact, Knight calls one of his two chip-making-equipment picks, Kulicke & Soffa Industries Inc., a "canary in the coal mine," meaning it's first to die—or to revive with the economy. Axcelis Technologies Inc. is his other choice. Another economic-recovery pick is Pride International Inc., a Houston oil-exploration company, since a healthier economy should lead to higher oil prices.

He's also betting that the war on terrorism will bring a long-term increase in defense spending. To that end, he chose two companies that service the aerospace and defense industries, Teledyne Technologies Inc. and Alliant Techsystems Inc. A somewhat contrarian play is SkyWest Inc., a Utah-based regional airline whose stock he thinks will take off as travelers return to the skies—and major carriers cut back service to

smaller cities that regionals can serve.

The rest of Knight's picks span a number of industries. Medical-supply maker PSS World Medical Inc. is looking for revenue growth from high-insurance-reimbursement rates. The stake in F&B Restaurants Inc., which operates some 3,800 fast-food restaurants, should fatten under new management. His bet on Alliance Gaming Corp., which makes casino equipment, is based on its expansion into new products. XM Satellite Radio Holdings Inc. will sing, he believes, as subscriptions to satellite radio programming catch on.

A Cross-Cultural Search for Quality

Frances Dydasco watched her highly rated foreign stock fund plunge 24.9% through Dec.

14, as stocks overseas fell further than U.S. ones. Next year could be another challenging one, but Dydasco hopes to avoid hitting the rocks again by an extra focus on quality.

She and her fellow managers at the T. Rowe Price International Discovery Fund will search for companies blessed with high returns on capital and superior products or market-share gains. She also wants them to have the strength to finance their own growth. Tech companies in particular will be scrutinized. One such pick is Tomen Electronics Corp., a Japanese distributor that helps foreign tech businesses break into the historically closed Japanese market. Partner Communications Co., an Israeli cell-phone outfit, should prosper as it targets high-end users and adds premium features.

Pharmaceuticals are another area of concentration. Dydasco thinks Galen Holdings PLC, based in Northern Ireland, could boost earnings 30% a year by buying up neglected products from drug companies and remarketing them, and also by developing its own treatments. Its new hormone-replacement device is expected to win U.S. Food & Drug Administration approval next year. Icon PLC of Ireland runs clinical tests for large drug companies and could see 15% to 20% earnings growth in 2002 and 2003, Dydasco says.

Several stocks for the new year play off consumer spending. One is Japanese cosmetics company Kose Corp., which has built a strong business with young, fashionable Japanese women through savvy marketing. Another, Sweden's Observer AB, analyzes media coverage to spot trends and sells the info to companies eager to market their products. Germany's Medion works with European retailers to find and import consumer electronics. France's Neopost is a fast-growing manufacturer of machines used to stamp postage on mail. They're not sold to consumers—but then again, who gets the mail?

Two other picks are based on changing cultural attitudes. "In the States, it's pretty normal for people to have five credit cards and to run up balances. In



Frances Dydasco

T. Rowe Price International Discovery Fund

COMPANY/Symbol/Country	PRICE*
AIFUL 8515 (JAPAN)	\$72.21
CORPORACION MAPFRE MAP (SPAIN)	5.83
GALEN HOLDINGS GALN (U.K.)	40.60
ICON ICLR (IRELAND)	28.50
KOSE 4922 (JAPAN)	29.50
MEDION MDN (GERMANY)	41.61
NEOPOST NEO (FRANCE)	30.76
OBSERVER OBS (SWEDEN)	6.53
PARTNER COMMUNICATIONS PTNR (ISRAEL)	6.00
TOMEN ELECTRONICS 7558 (JAPAN)	32.03

*As of Dec. 14 Data: Bloomberg Financial Markets

Japan, that has just not been the case," Dydasco says. But Japanese attitudes are changing—hence her recommendation of Aiful Corp., a consumer-finance company. Another choice is Corporacion Mapfre, a Spanish life insurer. Spaniards, Dydasco explains, "don't buy life insurance because they kind of think it hastens their death." Mapfre's business will liven up, she predicts, as Spaniards shed their superstition.

Size Doesn't Matter. The P-E Ratio Does

Many investment pros box themselves into buying just large-cap, mid-cap, or small-cap stocks. Ronald Muhlenkamp, who runs the Muhlenkamp Fund out of Wexford, Pa., doesn't believe in such strictures. His picks for 2002 run from financial giant Citigroup, with a market value of \$240 billion, to \$155 million Stanley Furniture Co.

What Muhlenkamp's 10 choices have in common is their relatively low valuations. He seeks companies that have returns on equity above 14%, with price-earnings ratios below their ROE. "In layman's terms, we look to buy Buicks at Chevy prices," he says. That strategy has earned him high marks—and a 17% annualized 10-year return through Dec. 14.



Ronald Muhlenkamp

Muhlenkamp Fund

COMPANY/SYMBOL	PRICE
ARKANSAS BEST ABFS	\$25.42
BEAZER HOMES USA BZH	71.98
CALPINE CPN	13.20
CEMEX CX	25.87
CENDANT CD	18.74
CITIGROUP C	46.69
FIDELITY NATIONAL FINANCIAL FNF	23.05
NVR NVR	192.50
STANLEY FURNITURE STLY	23.50
SUPERIOR INDUSTRIES INTERNATIONAL SUP	39.32

*As of Dec. 14

Data: Bloomberg Financial Markets

Underlying his stock picks is the conviction that the economy will recover in 2002. Consumer cyclicals have historically performed well in the early stages of a recovery. And Muhlenkamp's list includes four housing-related companies. He favors homebuilders Beazer Homes USA Inc. and NVR Inc. because they are grabbing market share from the independents. Fidelity National Financial Inc., a title-insurance company, stands to profit whether people buy homes in a strong economy or—as they have recently—refinance in a weak one. Stanley Furniture's sales would get its biggest boost from a recovery. But even in a struggling economy, sales for its youth furniture will hold up well, he says.

Two of his picks would benefit from a resurgence in the global economy. Muhlenkamp sees Citigroup's growth potential in providing banking services to developing nations. And shares of Mexican cement maker Cemex would firm in a building spurt.

The others are a hodgepodge. Superior Industries International Inc., an auto-part maker, will benefit if carmakers switch to aluminum wheels. Muhlenkamp thinks Arkansas Best Corp., a trucking firm that specializes in smaller loads, will likely prosper, too—particularly since potential competitors have high barriers to entry. Cendant Corp. would gain if increased travel creates a great

“In layman's terms, we look to buy Buicks at Chevy prices”

—RONALD MUHLENKAMP

need for its booking business.

Like all value investors, Muhlenkamp is drawn to stocks the rest of the market shuns. To the end, he calls power producer Calpine Corp. “irresistible” now that its stock has been beaten down by California's woes and the fears raised by Enron Corp.'s meltdown. “The more everyone else hates it,” he says, “the more we like it.”

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Topsy-Turvy All Over Again

Health care stumbled in 2001, but gold looked good

BY LEWIS BRAHAM

The investing climate for mutual funds was warmer in Siberia than Silicon Valley in 2001. In what turned out to be another topsy-turvy year, Russian stock funds soared while tech funds nosedived. If you need further evidence of how weird 2001 was, look at gold funds. The worst performers over the past two decades, they were tops—up an average of 16.5% (table, page 112).

With a lousy economy and a sinking stock market, equity funds were doomed. But believe it or not, they outperformed the Standard & Poor's 500-stock index. The total return of U.S. diver-

sified equity funds was down an average -11.4% vs. the S&P's -12.8% drop. (Returns are as of Dec. 12 and include appreciation plus reinvestment of dividends and capital gains before tax. The data is prepared for *BusinessWeek* by Standard & Poor's.)

Still, there was something familiar about 2001 results. Small-cap stock funds beat large cap, value funds bested growth, and steady-Edd bond funds rose 4.7%. International funds, down 17.2%, provided little haven for U.S. investors.

Fund shareholders didn't take kindly to the sinking fortunes. New money put into stock funds dried up, to just \$15 billion in 2001 through the end of October—a 95% drop from 2000. The returns from the nation's largest funds were particularly disappointing. Not one of the top 10 delivered a gain, although six lost less than the S&P. Meanwhile, the rivalry continued between the actively managed Fidelity Magellan Fund and the passive Vanguard 500 Index Fund. The two were neck and neck all year, ending it with nearly identical returns.

Among diversified stock funds, the only beacons were in the small-cap value category, which rose 11.1% as investors fled large stocks en masse. The best performers concentrated their portfolios in just a few positions. Ameristock Focus Value Fund, up 58.3%, has 60% of its assets in tiny stocks. "We're not seeing nearly as many bargain small-cap stocks as we did a year ago," says

The Best Equity Funds

FUND	TOTAL RETURN*	FUND	TOTAL RETURN*
PILGRIM RUSSIA A	69.68%	USAA PRECIOUS METALS & MINERALS	27.27%
SCHROODER CAPITAL ULTRA INV.	67.97	BUFFALO SMALL CAP	26.51
MATTHEWS KOREA	67.72	AL FRANK	26.46
AMERISTOCK FOCUSEO VALUE	58.33	BERWYN	26.03
CORBIN SMALL CAP VALUE	49.27	SPIRIT OF AMERICA INVESTMENT A	26.00
WASATCH MICRO CAP	43.70	ROYCE SPECIAL EQUITY	25.36
CGM FOCUS	42.72	BRIIDGEWAY MICRO-CAP LIMITED	25.01
BOSTON PARTN. SMALL CAP VAL. INSTL.	40.93	PROFUNDOS ULTRABEAR PROFUNO INV.	24.96
AEGIS VALUE	38.62	KENSINGTON STRATEGIC REALTY A	24.64
FRANKLIN MICROCAP VALUE	35.06	AMER. CENT. SMALL CAP VAL. INSTL.	24.26
FIDELITY ADVISOR KOREA A	32.98	HEARTLANDO VALUE	24.22
FIRST EAGLE SOGEN GOLD	32.71	AMER. AAOVANTAGE SMALL CAP VAL. MILE.	24.20
MERCURY HW SMALL CAP VALUE I	31.30	BABSON ENTERPRISE	24.06
TCW GALILEO VALUE OPPORTUNITIES I	30.97	TURNER SMALL CAP VALUE	23.77
AMERICAN CENTURY GLOBAL GOLD INV.	30.29	NI NUMERIC INVESTORS SMALL CAP VAL.	23.68
BRIIDGEWAY ULTRA-SMALL CO.	29.49	JOHNSON FAMILY SMALL CAP VAL.	23.61
THIRD MILLENNIUM RUSSIA	29.09	BURNHAM FINANCIAL SERVICES A	23.43
PERRITT MICRO CAP OPPORTUNITIES	28.95	OREYFUS GR. & VAL. SMALL COMP. VAL.	23.40
WASATCH SMALL CAP VAL.	28.69	RYDEX DYNAMIC TEMPEST 500	23.21
MONTEREY OCM GOLD	28.69	SCHWARTZ VALUE	22.99
HEARTLANDO VALUE PLUS	28.62	FIDELITY LOW PRICED STOCK	22.98
FBR SMALL CAP VALUE A	28.24	BANC STOCK GROUP A	22.87
KINETICS SMALL CAP OPPORTUNITY	28.24	MERRILL LYNCH ASSET BLD. MID CAP VAL. D	22.61
OELAFIELD	28.06	EVERGREEN PREC. MTL. HOLOINGS A	22.53
MERRILL LYNCH MASTER SMALL CAP VAL. C	27.38	GABELLI GOLD	22.05

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2001

Data: Standard & Poor's

s portfolio manager Nicholas D. Gerber. Not all small-cap managers agree. "Small-cap funds are still extremely cheap relative to large," says G. Kenneth Heebner, portfolio manager of Focus Fund. For example, CGM's stake in Beazer Homes USA Inc., though up 1%, trades at about a third of the price-earnings ratio of the S&P 500. "Beazer could triple in 2," Heebner says. He also concentrates his positions and has the ability to sell short, or bet against stocks. Although not short now, CGM Focus made money in 2001 shorting dot-com stocks.

Growth funds suffered across all market caps. Few that managed to stay in the black succeeded by avoiding the tech minefields. "It was business 101 for us," says portfolio manager John Thompson, whose large-cap Thompson Plumb Growth Fund was up 14.2%. "We avoided companies that weren't profitable—Internet, telecom equipment, and wireless stocks."

Thompson did buy some profitable tech stocks, such as Microsoft Corp., after September 11. He benefited from the fourth-quarter rally, spurred by the growing belief the economy will over soon with additional fiscal stimulus and rate cuts. But with the tech-heavy Nasdaq Composite Index up 34% in the fourth quarter, many fund managers now think the rally is overblown. Nothing has changed in the fundamentals of technology to warrant this kind of move," says Jay Krishnan, portfolio manager of Wasatch

Global Technology Fund.

Few sectors proved immune to the economic slowdown. While stalwart health-care and financial-services funds were safe havens in 2000, they stumbled in 2001, their averages falling 15.7% and 3.9%, respectively. "Financial-service stocks live and die on interest rates and credit quality," says David H. Ellison, portfolio manager of FBR Small Cap Financial Fund. "Lower interest rates were no problem, but everybody was worried about banks having a lot of nonperforming loans." Ellison delivered a 19.7% return by sticking to regional banks and thrifts with clean balance sheets.

The rally in gold funds may seem surprising after so many miserable years, but it's understandable given 2001's ugly economic climate. "Gold takes on the role of a pseudo-currency

How the Big Funds Fared

FUND	NET ASSETS BILLIONS	TOTAL RETURN*
FIDELITY MAGELLAN	\$73.3	-12.98%
VANGUARD 500 INDEX	67.4	-12.92
INVESTMENT CO. OF AMERICA A	50.6	-5.26
WASHINGTON MUTUAL INV. A	45.2	-0.21
FIDELITY GROWTH & INCOME	32.5	-10.63
GROWTH FUND OF AMERICA A	31.9	-11.93
FIDELITY CONTRAFUND	30.9	-14.78
NEW PERSPECTIVE A	25.8	-8.85
EUROPACIFIC GROWTH	25.7	-12.44
AMERICAN CENTURY ULTRA INV.	24.6	-16.81

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2001

Data: Standard & Poor's

The Worst Equity Funds

FUND	TOTAL RETURN*	FUND	TOTAL RETURN*
MERRILL LYNCH FOCUS TWENTY B	-69.00%	PILGRIM INTERNET A	-52.25%
BERKSHIRE FOCUS	-68.52	J.P. MORGAN H&Q TECHNOLOGY A	-52.21
BERKSHIRE TECHNOLOGY	-68.07	INVESCO TELECOMMUNICATIONS INV.	-52.01
PROFUNDUS ULTRAOTC PROFUND INV.	-64.99	MERRILL LYNCH PREMIER GROWTH B	-51.67
AN WAGONER MID CAP GROWTH	-63.95	AMERINCO TECHNOLOGY A	-50.81
AN WAGONER POST VENTURE	-62.03	ORBITEX EMERGING TECHNOLOGY A	-50.63
AN WAGONER TECHNOLOGY	-61.74	CONSECO SCIENCE & TECHNOLOGY Y	-50.57
AN KAMPEN TECHNOLOGY A	-61.67	IVY GLOBAL SCIENCE & TECH ADV.	-50.22
AN WAGONER EMERGING GROWTH	-59.77	IPS NEW FRONTIER	-49.86
PILGRIM GLOBAL COMMUNICATIONS A	-59.33	RED OAK TECHNOLOGY SELECT	-49.82
FIRSTHAND COMMUNICATIONS	-58.61	BERGER NEW GENERATION INSTL	-49.59
DELAWARE TECHNOLOGY & INNOVATION INSTL.	-58.26	AMERITOR SECURITY TRUST	-49.55
BLACK OAK EMERGING TECHNOLOGY	-57.30	BOYLE MARATHON	-49.31
IBP TRUCCROSSINGS TECHNOLOGY	-57.07	POTOMAC INTERNET PLUS	-49.17
ACOB INTERNET	-56.87	PBHG TECHNOLOGY & COMMUNICATIONS	-48.60
AMERINCO INTERNET B2B A	-56.81	INVESTEC INTERNET.COM INOEX	-48.57
AMERITOR INVESTMENT	-56.43	WWW INTERNET	-48.54
GRAND PRIX A	-55.92	FIRSTHAND E-COMMERCE	-48.42
PO PLUS AFTERMARKET	-53.94	RIGGS LARGE CAP GROWTH R	-47.93
FIRST AMERICAN TECHNOLOGY Y	-53.28	LOOMIS SAYLES AGGRESSIVE GROWTH RETAIL	-47.92
WILLAMETTE TECHNOLOGY	-53.11	NORTHERN GLOBAL COMMUNICATIONS	-47.60
OPPENHEIMER EMERGING TECHNOLOGIES Y	-52.91	FIDELITY AGGRESSIVE GROWTH	-47.55
MONETTA LARGE CAP EQUITY	-52.64	ALPHA ANALYTICS DIGITAL FUTURE	-47.20
AIM GLOBAL TELECOM AND TECH A	-52.61	IOEX MUNDER NET50 A	-47.20
AXP INNOVATIONS A	-52.53	IOEX PILGRIM BAXTER TECHNOLOGY A	-46.93

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2001

Data: Standard & Poor's

New
money
into stock
funds
dropped
95% from
the same
period
last year

Bond Funds Had More Fun

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
EMERGING MARKETS BDND	10.23%	MUNI. NEW YORK INTERMEDIATE	4.18%
LONG (GENERAL)	7.56	MUNI. SINGLE-STATE INTERMEDIATE	4.05
INTERMEDIATE (GENERAL)	7.30	MUNI. SINGLE-STATE LDNG	4.04
SHORT (GENERAL)	7.14	MUNI. NATIDNAL LDNG	3.71
INTERMEDIATE GOVERNMENT	7.06	MUNI. CALIF. LONG	3.70
SHORT GOVERNMENT	6.89	MULTISECTOR	3.62
ULTRASHORT	5.12	MUNI. NEW YDRK LDNG	3.37
LDNG GOVERNMENT	5.06	INTERNATIONAL BOND	2.68
MUNI. SHORT	4.49	HIGH YIELD	1.45
MUNI. HIGH YIELD	4.43	CONVERTIBLES	-8.23
MUNI. NATIONAL INTERMEDIATE	4.37	ALL TAXABLE BONOS	5.34
MUNI. CALIF. INTERMEDIATE	4.29	ALL NONTAXABLE BONDS	3.99

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2001
Data: Standard & Poor's

when investors panic," says William Martin, who runs the American Century Global Gold Fund, up 30.3%. "It's there to protect you from the complete unknown." Lower interest rates, a volatile U.S. dollar, and a demand-supply imbalance also gave the sector a boost.

Besides gold, real estate was the only positive fund sector, up 8.4% on average. "Real estate appeals to investors in this environment because of the relative certainty of the sector's cash flow," says Michael Winer, portfolio manager of the Third Avenue Real Estate Value Fund. Unlike most stocks, where the next quarter's earnings are anybody's guess, commercial real estate companies lock in their revenue in advance through long

leases. "Unless your tenants go bankrupt, your cash flow for the next three-four years is very visible," Winer says.

Foreign funds had an even bleak year than their U.S. cousins: Less than half had positive results. The reason, say money managers say, is the telecom and tech bubble of the 1990s was even more exaggerated overseas. "It was obvious during the bubble that there was a scarcity of legitimate foreign tech stocks," says Michael Welsh, portfolio manager of Oakmark International Small Cap Fund. "Many of these tangential European media and telecom companies were being dubbed Internet stocks, even though they were slow growers." The crash hit them hard.

Small stocks also rallied overseas, enabling Oakmark's fund to deliver a 9.8% return. Otherwise, only a few single-country funds racked up gains. Pilgrim Russia, with a 69.7% return, was the best-performing mutual fund this year, followed

closely by Matthews Korea Fund (table, page 110). Pilgrim's Samuel Oubadia says Russia's cheap oil stocks, 2001 tax cuts, and improving corporate governance were the main reasons for the surge. With oil prices now falling, 2002's outlook may not be as sanguine.

Once again, bond funds triumphed, with even category rising except convertible bonds, which fell 8.2%. (Convertible returns tend to follow the stock market.) Even junk-bond funds, after a brutal 2000, managed to eke out a 1.5% total return. Many debt experts now think junk is set for an excellent 2002. Although yields in the junk market, which average 12.92%, are enticing, working out the chaff can be difficult—and that's where a shrewd manager comes in. Pioneer High Yield Fund, up 15.5%, was the best in 2001.

With all the global jitters, who would have expected emerging-market debt funds—up 10.2% on average—to do so well? "As interest rates declined in developed nations, a lot of investors looked for yield in emerging markets," says Mohamed A. El-Erian, manager of PIMCO Emerging Markets Bond Fund, which soared 28.3% in 2001. Since emerging bonds are primarily government issues, El-Erian thinks they're less likely to default than junk debt. "Russia has over \$30 billion in reserves to service its bonds," El-Erian says. "It's hard to find a junk-bond company with that much cash." Although arguably safer than junk, Russian bonds still yield 13%.

Most bond managers agree that U.S. Treasury securities are played out. While government bonds had another banner year, Treasury yields, which range between 2% and 5.5%, are now so low that the likelihood of a repeat is slim. "It's very rare that the Treasury bond market beats the stock market two years in a row," says S. Kenneth Leech, CIO of Western Asset Management Co., a bond money management firm. For Treasuries to do well in 2002, investors would have to be fleeing the stock market again. Another victory for this sector would be a hollow one indeed.

A Few Bright Spots in Equity Funds

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
PRECIOUS METALS	16.53%	HEALTH	-15.70%
SMALL-CAP VALUE	11.13	NATURAL RESOURCES	-16.41
REAL ESTATE	8.35	DIVERSIFIED PACIFIC/ASIA	-18.04
MID-CAP VALUE	4.65	WORLD	-18.13
SMALL-CAP BLEND	-0.59	MID-CAP GRDWT	-21.11
PACIFIC/ASIA EX-JAPAN	-1.16	FDREIGN	-21.55
DIVERSIFIED EMERGING MARKETS	-3.32	LARGE-CAP GRDWT	-22.04
FINANCIAL	-3.94	EUROPE	-22.13
DOMESTIC HYBRID	-4.79	UTILITIES	-24.14
LARGE-CAP VALUE	-6.39	JAPAN	-25.42
LATIN AMERICA	-7.27	TECHNOLOGY	-32.82
INTERNATIONAL HYBRID	-7.28	COMMUNICATIONS	-33.62
MID-CAP BLEND	-8.33	U.S. DIVERSIFIED FUNDS	-11.35
ALL CAP	-9.66	INTL. EQUITY FUNDS	-17.16
LARGE-CAP BLEND	-13.98	ALL EQUITY FUNDS	-12.32
SMALL-CAP GRDWT	-15.17	S&P 500	-12.82

*Appreciation plus reinvestment of dividends and capital gains before taxes, Jan. 1 through Dec. 12, 2001 Data: Standard & Poor's

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Art Collectors Get Patriotic

The main trend in the market now is "Buy American"

BY THANE PETERSON

In the wake of the September 11 attacks, art dealers were among the most jittery of business people. New York is the center of the world art market, after all, and the big fall auctions were scheduled for early November. With the economy sinking, no one was sure collectors would turn out as usual to bid for million-dollar paintings and sculptures. Happily, many not only came but bid big bucks for choice pieces. The auctions "restored confidence" in the market, says Kent Logan, a retired securities executive, who with his wife Vicki is a major art collector in Vail, Colo. "A lot of collectors had been deferring decisions to see if the market was going to fall off a cliff. It didn't."

Although upbeat, art is not the overheated market it was back when newly minted millionaires drove up prices for trendy contemporary works to exorbitant levels. "A lot of the silliness and froth—the dot-com nonsense—is now gone," says Tobias Meyer, worldwide head of contemporary art at Sotheby's. But with a price-fixing scandal giving Sotheby's and Christie's a black eye and upstart auction house Phillips, de Pury & Luxembourg adding to the competitive heat, buyers were surprised by the market's relative strength. "Many [established] collectors showed up hoping to find bargains and ended up frantically bidding for the best works," says Marc Porter, international managing director at Christie's.

A case in point is Eli Broad, chairman of the Los Angeles-based financial services company SunAmerica Inc. He paid \$2.2 million for *Mirror #1*, a record for one of pop artist Roy Lichtenstein's mirror paintings, then ponied up \$2.5 million for an untitled drawing by Jasper Johns, another record. For both pieces, he paid above Sotheby's top estimated price. "I didn't see any bargains for [top-quality] work,"

Broad says. Another sign of the times: When London collector Charles Saatchi put *Blue Umbrella #2* by the American Alex Katz on the block, it fetched \$666,000, a record for that painter.

LOGANS: Like the stock market, art is also segmented, and prices and values fluctuate with demand. Jiangping Mei and



Michael Moses, business professors at New York University who have created an index of some 5,000 artworks sold and resold at auction, estimate that since 1990 the price of Impressionist works has fallen by 25%. By contrast, Old Master paintings soared 74%, and classic pre-World War II American paintings rose 91%.

Indeed, if there's a single dominant trend in the art market, it's "Buy American." It goes back at least to 1999, when Microsoft Chairman William H. Gates III paid \$36 million for *Lost in the Grand Banks* by Winslow Homer, according to *ARTnews* magazine—10 times the previous auction record for a Homer. This spring, Sid Kimmel, chairman of Jones Apparel Group, laid out a record \$6.2 million for a 1928 painting by Georgia O'Keeffe. Moses expects the price of classic American art to keep climbing because of the patriotic post-September 11 zeitgeist.

Post-World War II American works are plenty hot, too. That's less for patriotic reasons than because art historians, dealers, and collectors now regard the work as hugely important and are singling out artists—such as Andy Warhol, Lichtenstein, and Johns—as modern masters. "The great things from the post-World War II period are going to become unbelievably expensive," says Sotheby's Meyer.

When great Impressionist and Modern works do hit the market, the bidding is furious. At the fall art auctions, *Le Moteur* by Fernand Léger went for \$16.7 million and *Portrait of Mme. X* by Joan Miró for \$12.7 million. Camille Pissarro's *La Rue St. Lazare* sold for \$6.6 million. But y





FAIR WEATHER

FOR ART: This Alex Katz work went for \$666,000

you still find occasional bargains. Last month, investment money manager Scott Black, a savvy collector, nabbed an 1869 Renoir oil portrait for \$76,000—less than Christie's estimated \$800,000 minimum. Black thought the market had under-estimated the quality of the Renoir painting.

The big question now is whether art prices will crash in 2002. Art experts say a price decline usually lags an economic slowdown by up to a year. Broad isn't expecting a big correction like the one in 1990. "Good works will continue to command good prices," he says.

As usual, less-well-heeled collectors must search out more affordable niches. For instance, contemporary photography is still within reach of small collectors. Kelly Close, a San Francisco equity analyst with U.S. Bancorp Piper Jaffray, admires Mona Kuhn, whose latest photos go for about \$900. Close also is considering buying one of the recent nature prints of Richard Mischak, an established photographer who shows at San Francisco's Fraenkel Gallery. Asking price: \$1,400. Other collectors buy works of living painters and sculptors. Arthur Goldberg is high on two young artists, Amy Cutler and Mark Bradford, who show respectively at the Leslie Tonkonow and Lombard Freid galleries in New York. Bradford does colorful abstract paintings with elements of collage. Cutler does tightly executed paintings influenced by Persian miniatures.



Video art, shown on TV monitors, is also gaining in popularity. San Francisco venture capitalist Richard Kramlich has been buying pricey pieces by established stars, such as Bill Viola, whose works go to \$500,000, and Sherin Neshat, whose art can hit \$250,000. On a more affordable scale, he commissioned a work this year by the less-well-known Doug Akin for about \$40,000.

Experienced collectors say you shouldn't count on art being a good investment. "It's a passion, not a business," Broad says. Happily, though, art does tend to appreciate over time, according to NYU profs Mei and Moses. They figure that over the last 50 years, art has earned an average annual return after inflation of 8.2%, vs. the 8.9% annual return of the Standard & Poor's 500-stock index for the same period. The other good news: "We found that art prices seem to hold up reasonably well in times of recession and war," says Mei. You can't ask for more than that. ■

RECORD SALE: A Jasper Johns untitled drawing sold for \$2.5 million

A New Map for an Uncertain World

We've fine-tuned our methods for pinpointing stocks

BY ROBERT J. ROSENBERG

Sure, the stock market had a horrid year, and to many it still looks pretty scary. But remember that the stock market is just a market of stocks, and there are opportunities in many of them. So even during 2001, some companies, and even whole industries, made money for investors. CarMax Group, which sells new and used cars, more than quintupled

(through Nov. 30), and Service Corp. International, the funeral-home chain, gained 235%.

Of course, what worked in the past has passed. For 2002, investors need to go back to their sources to uncover new prospects. That's where *BusinessWeek's* Investment Outlook Scoreboard can help you. Encompassing 900 companies that are grouped into 24 industries, the Scoreboard presents information on the largest U.S. companies by sales. Standard & Poor's COMPUSTAT Data provided such data as price-earnings ratios and dividend yields. Thomson Financial/First Call delivered the earnings estimates and projected long-term growth rates based on its survey of 6,500 analysts.

We've also screened our broader list to provide a starting point in searching for good investment ideas. Last year, our screens, which were based on various investment approaches, returned 2.3% on average, compared with -7.1% for the Dow Jones industrial average, -12.6% for the Standard & Poor's 500-stock index, and -21.6% for the Nasdaq Composite Index (through Nov. 30). This year, we've continued to fine-tune our old approaches and added a new one.

We're still looking for companies with earnings momentum (table), because strong earnings growth often leads to higher stock prices. For instance, analysts are projecting chemical companies' earnings to increase 57% in 2002. Profits among nonferrous metals companies are projected to jump 500%. We think that's what the analysts say.

That's why we also screen for value stocks. In general, these stocks don't depend solely on an earnings forecast. They may be rich in assets or pay bountiful dividends. Our bargain-stock screen, for instance, looks for companies selling with low price ratios and low price-to-book-value ratios. Last year's bargain list gained 36%.

Be careful. Stocks are usually cheap for a reason. Provident Financial Corp., which tops this year's list of bargain stocks, has lost 95% of its market value as investors questioned the quality of the credit-cash issuer's receivables. In fact, regulators recently barred Provident from issuing new cards to people with poor credit histories. Is it a bad stock? If the economy continues to tank, it can't be good. But if the economy recovers—and credit worries recede—the stock could be a steal. Dura Automotive Systems Inc., a repeat from last year, still trades at a discount to book value, even after appreciating 75%.

If the slowdown drags on and the market trades in a narrow range, our large-cap, high-yielding list should work well. It includes the tobacco stocks—R.J. Reynolds Tobacco, Philip Morris, and UST. They offer protection against a general market downturn, and their dividend yields approach the yield on 10-year Treasury bonds.

There's even a dividend play in technology. Lighting-parts maker Hubbell Inc. yielded

Industry Group Winners & Losers

2001 WINNERS

EARNINGS CHANGE FROM 2000

GLASS CONTAINERS	839%
FOOD RETAILING	571
FOOD DISTRIBUTION	438
MISCELLANEOUS LEISURE	131
POLLUTION CONTROL	108
PETROLEUM SERVICES	97
COMPUTER SOFTWARE & SVCS.	67
SAVINGS & LOAN	46
DRUGS & RESEARCH	46
TEXTILES	43

2002 WINNERS

EST. EARNINGS CHANGE FROM 2001

NONFERROUS METALS	500%
ALUMINUM	169
COMPUTERS & PERIPHERALS	148
TIRE & RUBBER	117
FINANCIAL SERVICES	106
INSURANCE	77
FOREST PRODUCTS	75
TRANSPORTATION SERVICES	73
TRUCKING & SHIPPING	71
CHEMICALS	57

2001 LAGGARDS

EARNINGS CHANGE FROM 2000

ELECTRONICS	-85%
NONFERROUS METALS	-80
ALUMINUM	-68
CARS & TRUCKS	-64
FINANCIAL SERVICES	-62
AUTO PARTS & EQUIPMENT	-59
FOREST PRODUCTS	-58
PAPER	-54
TRUCKING & SHIPPING	-52
TIRE & RUBBER	-47

2002 LAGGARDS

EST. EARNINGS CHANGE FROM 2001

COAL, OIL & GAS	-38%
PETROLEUM SERVICES	-12
INSTRUMENTS	-3
CONSTRUCTION & REAL ESTATE	-1
AEROSPACE & DEFENSE	1
HOTEL & MOTEL	3
BANKS-WEST & SOUTHWEST	3
CARS & TRUCKS	4
TOBACCO	5
ELECTRIC UTILITIES	7

Because of losses in 2000 and/or estimated losses in 2001, earnings gains or losses cannot be meaningfully calculated on a percentile basis for the airlines, broadcasting, drug-distribution, entertainment, health-care services, semiconductor, steel, and telecommunications-equipment industries. And because of estimated losses in 2001 or 2002, earnings gains or losses cannot be meaningfully calculated on a percentile basis for the airlines, broadcasting, drug-distribution, semiconductor, steel, and telecommunications-equipment industries.

Data: Thomson Financial/First Call, Standard & Poor's COMPUSTAT

right 4.9%, and earnings are growing at 10% per year. What will catch your eye on that table is WorldCom Group, a carve-out from WorldCom Inc., with 18.3% yield. That's not a typo. But whenever you see something so far from the pack, you have to question it. In this case, the company has had only one quarter's worth of dividends and declared two more. The annualized rate of that dividend comes out to 18.3%. What's the market thinking here? Either there's doubt about whether WorldCom can continue to pay, or the company is so far from investors' radar that they haven't noticed. In that case, the stock could be a steal.

Finally, some strategists believe buying fast-growing tech stocks is still the best play. The thinking: The stocks are down so far they can only go up. So we created a screen of tech stocks with high earnings expectations. But we also added the S&P rankings as a reality check. So the companies on the list, which starts with Linear Technology Corp., have at least 20% long-term growth prospects, and the worst of them are rated B+ by S&P.

Our screens are just starting points. So dive into our Scoreboard. The market will reward your efforts. ■

A Menu of Investment Opportunities

These six tables show the companies that scored the highest based on various financial criteria. Be careful, though: Unusually high or low results could also be a sign of trouble. This is just the start for further research.

BIG CAPS WITH THE HIGHEST DIVIDEND YIELD

These companies have a market capitalization of at least \$5 billion and pay the highest dividends, excluding utilities and REITs

	PERCENT
J. REYNOLDS TOBACCO HOGS. RIR	6.1%
EASTMAN KODAK EK	6.0
KEYCORP KEY	5.2
JST UST	5.1
PHILIP MORRIS MO	4.9
AM SOUTH BANCORP ASO	4.8
UNION PLANTERS UPC	4.6
H.J. HEINZ HNZ	4.3
NATIONAL CITY NEC	4.2
CONAGRA FOODS CAG	4.1

STOCKS WITH A LOW PRICE-TO-BOOK RATIO

These companies have an S&P Equity Ranking of at least A- and a relatively low price-to-book ratio

	PRICE AS PERCENT OF BOOK VALUE	S&P EQUITY RANKING
OILLARD'S DDS	54%	A
ROYAL CARIBBEAN CRUISES RCL	78	A
ONEOK OKE	80	A-
CONSTELLATION ENERGY GROUP CEG	95	A-
NATIONAL SERVICE INOS. NSI	102	A-
CINCINNATI FINANCIAL CINF	105	A-
WATSCO WSO	106	A
HUGHES SUPPLY HUG	107	A-
UTILICORP UNITED UCU	113	A-
AVNET AVT	117	A-

CHEAP STOCKS

Companies with both a low price-to-book ratio and a low price-earnings ratio

	PRICE AS PERCENT OF BOOK VALUE	P-E RATIO
PROVIDENT FINANCIAL PVN	32%	1
INTEGRATED ELECTRICAL SVCS. IEE	32	6
SPHERION SFN	40	5
TESORO PETROLEUM TSO	52	5
KAISER ALUMINUM KLU	65	1
ENCOMPASS SERVICES ESR	13	8
DURA AUTOMOTIVE SYSTEMS DURA	35	7
OWENS-ILLINOIS OI	72	3
AVISTA AVA	78	4
COMPUCOM SYSTEMS CMPC	45	9

TECH WITH A DIVIDEND

Tech stocks that pay dividends tend to be in the less glamorous corners of the sector

	PERCENT
MCI GROUP MCIT	18.3%
HUBBELL HUB.B	4.9
NATIONAL SERVICE INDUSTRIES NSI	4.0
ROCKWELL INTERNATIONAL ROK	4.0
COOPER INDUSTRIES CBE	3.4
VERIZON COMMUNICATIONS VZ	3.3
SMITH (A.O.) AOS	2.9
EMERSON ELECTRIC EMR	2.9
PITNEY BOWES PBI	2.8
SBC COMMUNICATIONS SBC	2.7

HIGH-GROWTH TECH STOCKS

Technology companies projected to have higher-than-average long-term earnings growth

	PRICE CHANGE DEC. 31, 2000-NOV. 30, 2001	LONG-TERM EARNINGS GROWTH	S&P EQUITY RANKING
LINEAR TECHNOLOGY LLTC	-11	25.0%	A
TELEPHONE AND DATA SYSTEMS TDS	0	24.0	A-
CITIZENS COMMUNICATIONS CZN	-25	20.0	A-
ELECTRONIC ARTS ERTS	42	25.0	B+
MAXIM INTEGRATED PRODS. MXIM	15	25.0	B+
PEOPLESFT PSFT	-6	25.0	B+
BENCHMARK ELECTRONICS BHE	-15	25.0	B+
SYMBOL TECHNOLOGIES SBL	-31	25.0	B+
CISCO SYSTEMS CSCO	-47	25.0	B+
SOLETRON SLR	-57	25.0	B+

HIGH HOPES FOR EARNINGS

These companies' earnings are forecast to move ahead strongly in 2002

	PERCENT CHANGE 2001-2002
E*TRADE GROUP ET	325%
BMC SOFTWARE BMC	100
AGCO AG	97
TRANSOCEAN SECO FOREX RIG	93
PROVIDENT FINANCIAL GRP. PFGI	92
GATX GMT	88
XILINX XLNX	85
PITTSTON PZB	82
TEXAS INDUSTRIES TXI	66
EBAY EBAY	57

Thomson Financial/First Call estimates as of Nov. 29. All other data as of Nov. 30.
Data: Thomson Financial/First Call, Standard & Poor's COMPUSTAT

2002

Investment Outlook Scoreboard

Glossary

MARKET VALUE: Share price on Nov. 30, 2001, multiplied by the latest available common shares outstanding.

RECENT SHARE PRICE: Price for a single share of a company's most widely traded issue of common stock as of the close of trading Nov. 30, 2001.

PRICE CHANGE: Percentage change in the company's most widely traded common-stock issue since Dec. 31, 2000.

EARNINGS GROWTH: Compound annual growth rate, calculated using the 1996 and 2000 restated basic earnings per share (unless noted otherwise).

RETURN ON EQUITY: The latest available net income available for shareholders divided by total equity.

PRICE AS PERCENTAGE OF BOOK VALUE: Share price on Nov. 30, 2001, as a percentage of the latest available book value per share, which is the sum of common stock at nominal balance-sheet value, capital surplus, and retained earnings as shown in company accounts divided by the number of shares outstanding.

P-E RATIO: Price-earnings ratio based on the latest available 12 months earnings and Nov. 30, 2001, stock price.

PRICE-SALES RATIO: Based on the latest available 12 months sales and the Nov. 30, 2001, stock price.

PRICE-EARNINGS TO GROWTH RATE: The price-earnings ratio based on the 2001 earnings estimate and Nov. 30, 2001, stock price, divided by the long-term earnings growth rate.

DIVIDEND YIELD: Indicated annual dividend as a percent of the Nov. 30, 2001, stock price.

EARNINGS PER SHARE: Diluted earnings per share-net income (including proceeds from certain convertible securities, warrants, and options that are common-stock equivalents, but excluding extraordinary profits or losses) divided by number of common and common equivalent shares.

EARNINGS PER SHARE ESTIMATES: Analysts' consensus estimates for 2001 and 2002 compiled by Thomson Financial/First Call.

VARIATION: The percentage by which two-thirds of the 2002 earnings estimates are above or below the average estimate. The lower this figure is, the more analysts agree on their estimates.

LONG-TERM EARNINGS GROWTH: Median estimate by analysts of the annual growth rate of earnings compiled by Thomson Financial/First Call. For most companies, this is for the next 3-5 years.

S&P EQUITY RANKING: A measure of a company's historical growth of earnings and dividends, using Standard & Poor's computerized scoring system based on the most recent 10 years' earnings per share and dividends.

EARNINGS PER SHARE

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	2002 ESTIMATES FROM ANALYSTS		S&P EQUITY RANK
																LONG-TERM GROWTH RATE %	EST. RATE %	
ALL-INDUSTRY AVERAGE		12373.1	110	7	12.7	9.1	325	32	1.5	2.5	1.37	3.96	2.23	3.66	27.1	13.8		
1 AEROSPACE & DEFENSE																		
INDUSTRY AVERAGE		12352.1	49	-6	18.2	16.1	274	23	0.8	1.7	1.72	3.07	3.13	3.16	4.4	11.6		
BOEING BA		29394.5	35	-47	7.2	28.4	260	9	0.5	0.7	1.94	2.44	3.60	3.11	9.7	15.0	8	
GENERAL DYNAMICS GD		16778.4	83	7	30.0	20.7	379	18	1.5	1.9	1.35	4.48	4.50	5.10	2.0	10.0	8	
GOODRICH GR		2484.3	24	-33	NA	15.8	166	9	0.6	0.7	4.51	2.68	3.04	2.58	6.6	12.0	8	
LOCKHEED MARTIN LMT		20345.1	46	37	NM	8.7	260	29	0.8	2.9	0.95	-1.05	1.45	1.76	1.7	11.0	8	
NEWPORT NEWS SHIPBUILDING NNS		1996.2	68	30	16.1	31.6	657	22	0.9	2.1	0.24	2.77	3.24	3.54	7.1	10.0	N	
NORTHROP GRUMMAN NOC		8042.9	94	13	13.9	7.6	152	17	0.7	1.0	1.70	8.82	6.19	6.85	2.8	15.6	B	
PRECISION CASTPARTS PCP (3)		1327.0	26	-39	17.8	12.4	139	11	0.5	0.8	0.47	2.45	2.83	2.38	8.4	12.0	A	
RAYTHEON RTN		11860.2	33	6	NA	1.3	112	76	0.7	2.0	2.44	1.46	1.37	1.39	1.4	12.0	8	
ROCKWELL COLLINS COL (9)		3086.3	17	NA	NA	12.5	278	NA	1.1	4.4	2.14	NA	1.27	1.19	1.7	3.0	N	
UNITED TECHNOLOGIES UTX		28206.0	60	-23	24.6	22.5	335	15	1.0	1.1	1.50	3.55	3.81	3.72	3.0	15.0	8	
2 AUTOMOTIVE																		
INDUSTRY AVERAGE		4921.1	26	17	3.8	-0.8	131	34	0.3	9.3	1.40	2.36	0.92	1.24	63.6	9.9		
(A) CARS & TRUCKS																		
GROUP AVERAGE		13881.5	42	8	18.0	5.5	192	32	0.4	2.5	1.99	4.31	1.54	1.60	51.4	8.6		
FORD MOTOR F		34298.0	19	-19	1.9	5.1	257	56	0.2	NM	3.17	3.59	-0.07	0.76	54.0	5.5	B	
GENERAL MOTORS GM		27555.6	50	-2	7.6	1.4	96	NM	0.2	3.2	4.02	6.68	3.07	1.70	52.9	5.0	8	
NAVISTAR INTERNATIONAL NAV (10)		2173.5	37	40	NM	-2.0	194	NM	0.3	NM	0.00	2.58	-0.39*	0.47	136.2	9.0	B	
DSHKOSH TRUCK OTRK (9)		712.5	43	-3	40.6	14.7	205	14	0.5	1.0	0.81	2.96	2.98*	2.56	4.3	15.0	B	
PACCAR PCAR		4668.0	61	24	22.1	8.3	208	25	0.8	3.4	1.97	5.73	2.09	2.51	9.6	8.5	A	
(B) PARTS & EQUIPMENT																		
GROUP AVERAGE		1868.2	21	20	3.7	-3.3	110	22	0.2	8.5	1.00	1.85	0.76	1.15	72.4	10.8		
AMERICAN AXLE & MFG. HOLDINGS AXL		970.6	19	145	48.1	21.2	189	9	0.3	0.9	0.00	2.60	2.25	1.96	10.2	10.0	N	
ARVINMERITOR ARM (9)		1189.5	18	59	-42.9a	5.4	183	34	0.2	3.8	2.22	4.12	0.53*	1.61	23.6	9.0	N	
AUTOLIV ALV		1806.3	18	16	-5.1	2.2	97	44	0.5	1.1	2.38	1.67	0.98	1.28	12.5	17.0	N	
BORGWARNER BWA		1210.4	46	15	19.1	6.5	109	17	0.5	1.5	1.30	3.54	3.15	3.39	13.0	10.0	N	
DANA DCN		2034.8	14	-11	-6.1	-3.6	86	NM	0.2	19.6	0.29	2.18	0.07	0.20	105.0	10.0	8	
DELPHI AUTOMOTIVE SYSTEMS DPH		7685.9	14	22	0.8	-1.2	234	NM	0.3	3.5	2.04	1.88	0.39	0.47	36.2	10.0	N	
DURA AUTOMOTIVE SYSTEMS DURA		157.9	9	69	11.1	5.0	35	7	0.1	0.6	0.00	2.35	1.60	1.40	40.7	10.0	N	
EATON ETN		4824.0	70	7	6.5	8.0	197	25	0.6	2.1	2.53	5.00	3.26	3.98	11.6	10.0	A	

FOOTNOTES: *Actual, not estimated data. NA=not available. NM=not meaningful. NR=not ranked. (a) Four-year compound growth rate. (b) Final year of growth rate calculation is 2000. (c) Pro forma data. Data compiled by Standard & Poor's COMPUSTAT from such sources such as statistical services, registration statements, and company reports that COMPUSTAT believes to be reliable but are not guaranteed by COMPUSTAT or BusinessWeek as to correctness or completeness. This material is not an offer to buy or sell any security. Additional data from Thomson Financial/First Call.

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2000 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2002 ESTIMATES FROM ANALYSTS					S&P EQUITY RANKING
											2000 ACTUAL	2001 ANALYST EST	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	
FEDERAL-MOGUL FMO	81.9	1	-56	NM	NM	14	NM	0.0	NM	0.00	-4.02	-2.30	-1.25	197.6	10.3	D
LEAR LEA	2286.1	36	44	13.8	9.7	143	16	0.2	1.7	0.00	4.17	2.37	2.36	8.9	9.0	NR
INNESCO AUTOMOTIVE TEN	60.3	2	-48	NM	-38.8	25	NM	0.0	NM	0.00	-1.18	-0.38	-0.25	244.0	5.0	C
ISTEON VC	1794.0	14	20	-8.4	-5.7	54	NM	0.1	50.2	1.74	2.08	0.05	0.26	157.7	5.5	NR
ABASH NATIONAL WNC	184.7	8	-7	NM	-47.9	69	NM	0.2	NM	0.50	-0.38	-2.08	-0.41	80.5	25.0	8+

C) TIRE & RUBBER

GROUP AVERAGE	2364.5	19	19	-23.9	-1.5	114	124	0.3	23.5	2.49	0.78	0.41	0.89	36.4	7.3	
GOODYEAR TIRE & RUBBER CT8	1075.6	15	39	0.2	1.0	117	124	0.3	2.2	2.83	1.31	0.71	1.15	25.2	9.5	A-
GOODYEAR TIRE & RUBBER GT	3653.4	22	-3	-48.0	-4.0	110	NM	0.3	44.8	2.14	0.25	0.10	0.63	47.6	5.0	8+

BANKS

INDUSTRY AVERAGE	15531.3	37	1	8.8	14.3	246	18	2.3	1.5	2.83	2.09	2.36	2.65	7.1	11.0	
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A) BANKS - EAST

GROUP AVERAGE	18614.2	41	-3	15.3	16.1	302	19	2.6	1.5	2.51	2.31	2.36	2.69	3.2	12.2	
ASSOCIATED BANC-CORP AS8C	2255.1	34	13	12.2	16.0	209	13	2.0	1.4	3.62	2.46	2.65	2.89	2.4	9.0	A
BANK OF NEW YORK 8K	28903.5	39	-29	10.7	21.4	447	21	3.9	1.5	1.83	1.92	2.06	2.22	3.2	13.0	A
BANKNORTH GROUP 8KNG	2964.4	22	9	10.9	16.4	203	13	1.9	1.2	2.49	1.32	1.77	1.97	3.6	10.0	8
CLONIAL BANCORP CN8	1467.1	13	23	17.3	14.0	175	12	1.5	1.1	3.62	1.06	1.10	1.21	4.1	11.0	A-
COMMERCE BANCORP C8H	2435.1	75	9	20.2	15.1	382	26	3.2	1.7	2.94	2.49	3.00	3.46	0.9	15.0	A
JEETBOSTON FINANCIAL F8F	39517.3	37	-2	18.8	11.0	203	17	2.0	1.3	3.81	3.68	2.61	3.10	2.9	10.5	A-
P. MORGAN CHASE JPM	74416.7	38	-17	12.3	6.3	178	29	1.4	1.6	3.61	2.86	2.03	3.05	7.5	12.0	8+
MT BANK MT8	6671.0	71	4	12.1	11.8	226	20	2.6	1.7	1.42	3.44	3.83	4.24	1.2	11.0	A
IBNA KR8	27461.4	32	-13	26.9	21.3	371	18	2.9	0.9	1.12	1.53	1.90	2.20	3.6	20.0	A+
ELLON FINANCIAL MEL	17492.3	37	-24	11.6	20.6	491	25	3.6	2.0	1.28	2.03	1.57	1.84	5.4	12.0	A-
ORTH FORK BANCORPORATION NF8	4913.4	30	23	17.7	22.4	448	15	4.1	1.4	2.77	1.39	2.03	2.18	1.4	11.0	8
NC FINANCIAL SERVICES GROUP PNC	16457.8	58	-21	9.1	16.9	241	15	2.2	1.4	3.31	4.09	4.10	4.37	3.2	10.0	A-
TATE STREET STT	17029.7	52	-16	19.6	15.9	447	29	2.8	1.8	0.76	1.82	1.99	2.19	1.8	14.4	A+

B) BANKS - MIDWEST

GROUP AVERAGE	18380.6	38	-9	10.1	13.0	257	20	2.4	1.5	2.98	2.05	2.33	2.75	3.4	10.6	
BANK ONE ONE	43695.5	37	2	NM	7.9	216	27	1.7	1.5	2.24	-0.45	2.46	2.75	3.3	10.0	A-
AMERICA CMA	9137.8	51	-14	8.2	14.4	190	13	2.1	1.1	3.43	4.63	4.72	4.99	1.8	10.0	A+
COMMERCE BANCSHARES C8SH	2481.5	38	-7	12.9	14.4	197	14	2.4	1.5	1.70	2.63	2.69	2.87	2.4	9.5	A+
FTH THIRO BANCORP FIT8	34712.1	60	1	17.1	12.8	469	35	5.7	1.8	1.33	1.83	2.36	2.73	1.8	14.5	A+
IRSTMERIT FMR	2147.8	25	-5	14.3	17.1	228	14	2.3	1.4	3.79	1.80	1.87	2.09	2.9	9.5	A-
UNTINGTON BANCSHARES H8AN	4066.8	16	0	2.6	7.9	169	22	1.6	1.8	3.95	1.32	1.16	1.32	5.3	8.0	A-
EYCORP KEY	9696.5	23	-18	8.2	9.1	147	16	1.2	1.7	5.15	2.30	1.73	2.33	4.3	8.0	A+
ARSHALL & ILSLEY MI	6542.7	61	21	9.2	12.0	253	21	1.9	1.7	1.89	2.91	3.69	3.97	2.0	10.0	8+
ATIONAL CITY NCC	16968.3	28	-3	9.3	18.7	236	13	1.8	1.5	4.21	2.13	2.27	2.43	2.9	8.0	A
ORTHERN TRUST NTRS	12847.1	58	-29	17.5	18.6	493	26	3.7	2.0	1.18	2.08	2.22	2.40	1.7	13.0	A
ROVIOENT FINANCIAL GROUP PFGI	1115.3	23	-40	-6.8a	5.5	119	22	0.8	1.4	4.23	1.46	1.47	2.82	8.2	11.0	A
CF FINANCIAL TC8	3534.1	46	3	NA	22.9	393	17	2.9	1.3	2.18	2.35	2.68	3.02	2.7	13.0	A-
.S. BANCORP US8	37371.0	19	-18	15.0	8.1	222	21	2.6	1.2	3.95	1.32	1.32	1.77	4.0	12.0	NR
WELLS FARGO WFC	73011.8	43	-23	13.2	12.3	270	22	2.5	1.8	2.43	2.33	2.01	2.99	5.0	12.0	A

C) BANKS - SOUTH & SOUTHEAST

GROUP AVERAGE	16083.7	34	11	1.3	13.8	223	17	2.2	1.5	3.27	1.94	2.41	2.66	3.2	10.2	
MSOUTH BANCORPORATION ASO	6685.3	18	20	-3.7	17.6	225	13	1.9	1.4	4.80	0.86	1.44	1.56	3.9	9.0	A-
BANK OF AMERICA BAC	97111.1	61	34	7.5	12.2	194	16	1.8	1.3	3.91	4.52	4.91	5.33	2.8	10.0	A-
B&T 88T	15469.4	34	-8	7.0	15.4	259	17	2.5	1.2	3.05	1.55	2.39	2.67	2.3	11.5	A-
COMPASS BANCSHARES C8SS	3463.1	27	13	11.3	14.7	197	13	1.8	1.3	3.40	2.00	2.09	2.26	3.1	10.0	A+
IRST TENNESSEE NATIONAL FTN	4529.0	36	24	7.5	21.7	315	15	1.8	1.5	2.78	1.77	2.25	2.49	3.6	11.0	A+
IRST VIRGINIA BANKS FVB	2292.5	48	-1	6.6	14.1	200	14	2.9	2.2	3.35	3.01	3.12	3.31	3.0	7.0	A
IBERNIA H18	2604.9	16	28	6.4	10.7	170	15	1.7	1.4	3.42	1.04	1.35	1.46	3.4	9.0	8
ATIONAL COMMERCE FINANCIAL NCF	4896.8	24	-3	-29.4	6.5	203	32	3.1	1.7	2.50	0.28	1.11	1.52	6.6	13.0	A
EGIONS FINANCIAL RG8K	6542.6	29	5	9.9	12.6	166	13	1.6	1.6	3.89	2.38	2.30	2.44	3.3	8.0	A
OUTHTRUST SOTR	8385.5	24	20	12.4	13.7	215	16	2.2	1.4	2.29	1.43	1.61	1.76	1.7	11.0	A+
UNTRUST BANKS STI	18265.8	63	0	13.4	16.7	223	14	2.1	1.3	2.53	4.30	4.75	5.02	2.8	10.0	A+
YNOVUS FINANCIAL SNV	6839.8	24	-13	14.6	18.6	423	23	3.3	1.5	2.17	0.92	1.05	1.20	1.7	15.0	A+
INION PLANTERS UPC	5962.7	43	21	7.3	13.4	187	14	1.9	1.7	4.61	3.00	3.19	3.53	2.0	8.0	8+
VACHOVIA W8	42122.8	31	11	-52.4	5.4	148	20	1.9	1.4	3.10	0.12	2.16	2.66	4.1	10.0	A-

D) BANKS - WEST & SOUTHWEST

GROUP AVERAGE	3002.5	32	11	9.8	14.7	168	14	1.8	1.3	2.23	2.06	2.32	2.40	29.5	11.3	
BANCWEST BWE	4339.2	35	33	8.8	11.6	203	18	2.6	2.0	2.19	1.73	1.92	2.14	0.9	9.0	A-
OK FINANCIAL 80KF	1613.6	32	53	15.7	13.4	197	16	1.7	NA	0.00	1.75	1.98	2.38	3.8	NA	8+
CITY NATIONAL CYN	2093.4	44	12	16.4	16.1	239	15	2.7	1.4	1.70	2.72	2.93	3.21	2.2	11.0	8
PACIFIC CENTURY FINANCIAL 80H	1995.7	25	42	-3.2	9.1	146	17	1.7	2.1	2.86	1.42	1.48	1.93	7.3	8.0	8+
PROVIOIAN FINANCIAL PVN	758.8	3	-95	NA	30.1	32	1	0.1	0.1	4.49	2.23	1.81	0.34	185.3	15.0	NR
UNIONBANCAL US	5774.8	37	53	18.7	10.1	163	16	1.9	1.3	2.72	2.72	2.91	3.24	4.3	10.0	A-
IONS BANCORPORATION ZION	4441.8	48	-23	2.3	12.7	199	15	2.2	1.0	1.66	1.86	3.23	3.54	2.5	15.0	A

EARNINGS PER SHARE

													2002 ESTIMATES FROM ANALYSTS				
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	
4 CHEMICALS																	
INDUSTRY AVERAGE																	
AIR PRODUCTS & CHEMICALS APD (9)																	
CABOT CBT (9)																	
CROMPTON CK																	
CYTEC INDUSTRIES CYT																	
OWW CHEMICAL OOW																	
OUPONT DO																	
EASTMAN CHEMICAL EMN																	
FERRO FOE																	
FULLER (H.B.) FULL (11)																	
GEORGIA GULF GGC																	
GRACE (W.R.) GRA																	
GREAT LAKES CHEMICAL GLK																	
HERCULES HPC																	
IMC GLOBAL IGL																	
INTERNATIONAL FLAVORS & FRAGRANCES IFF																	
LUBRIZOL LZ																	
LYONDELL CHEMICAL LYO																	
MILLENNIUM CHEMICALS MCH																	
MONSANTO MON																	
POLYONE POL																	
PRAXAIR PX																	
ROHM & HAAS ROH																	
SCOTTS SMG (9)																	
SOLUTIA SOI																	

5 CONGLOMERATES

INDUSTRY AVERAGE	35896.3	23	20	9.7	0.7	233	124	0.9	3.2	1.82	1.14	1.19	1.40	11.5	11.6			
ALLEGHENY TECHNOLOGIES ATI	1239.2	15	-3	3.6	2.6	124	45	0.6	7.2	5.18	1.60	0.33	0.55	52.7	6.5			
ANIXTER INTERNATIONAL AXE	1060.2	29	33	47.0	7.9	191	26	0.3	1.3	0.00	2.03	1.45	1.43	11.2	15.0			
GENERAL ELECTRIC GE	382204.1	39	-20	15.3	25.7	713	28	3.0	1.7	1.66	1.27	1.41	1.60	1.9	16.0			
HONEYWELL INTERNATIONAL HON	26949.1	33	-30	4.0	0.4	291	B29	1.1	1.2	2.26	2.05	2.05	2.16	3.7	13.5			
IKON OFFICE SOLUTIONS IKN (9)	1520.3	11	329	-37.2	1.2	104	89	0.3	17.9	1.49	0.18	0.12*	0.78	15.4	5.0			
PALL PLL (7)	2817.3	23	8	16.0	14.7	370	26	2.3	2.0	2.95	1.18	0.95*	1.03	4.9	12.0			
PEPSIAMERICAS PAS	1962.2	13	-23	2.6	5.4	129	24	0.6	1.7	0.32	0.51	0.62	0.75	5.3	12.0			
TEXTRON TXT	5600.7	40	-15	1.4	-8.3	151	NM	0.5	1.3	3.28	1.90	2.35	3.06	6.2	13.0			
TRW TRW	4927.7	39	1	26.0	-1.1	212	NM	0.3	1.7	1.79	3.51	2.31	2.38	10.9	10.0			
U.S. INDUSTRIES USI (9)	163.4	2	-73	-20.1	-64.4	36	NM	0.1	0.4	0.00	0.43	0.49	0.47	NA	12.0			
VIAO VVI	1839.6	21	-10	48.6	7.8	254	32	1.1	1.3	1.73	1.58	1.19	1.46	2.1	13.7			
WALTER INDUSTRIES WLT	471.5	11	41	NM	17.0	223	13	0.2	1.1	1.13	-2.62	1.00	1.15	12.2	10.0			

6 CONSUMER PRODUCTS

INDUSTRY AVERAGE	14753.5	35	12	10.7	21.0	610	29	1.4	3.1	1.54	1.73	1.80	2.15	4.0	13.0			
(A) APPAREL																		
GROUP AVERAGE	3322.3	30	-2	3.8	12.2	200	15	0.7	1.2	1.09	1.83	2.01	2.27	4.0	12.6			
JONES APPAREL GROUP JNY	3918.1	31	-3	34.8	14.3	209	15	1.0	0.9	0.00	2.48	2.28	2.49	3.2	15.0			
KELLWOOD KWD (1)	503.2	22	5	17.7a	8.5	109	13	0.2	1.4	2.89	2.57	1.55	1.85	3.2	10.0			
LIZ CLAIBORNE LIZ	2629.1	50	20	12.6	18.8	260	14	0.8	1.1	0.90	3.43	3.80	4.18	2.2	12.5			
NIKE NKE (5)	14234.4	53	-5	-5.7	15.9	387	25	1.5	1.5	0.91	2.16	2.37	2.68	3.7	15.0			
PHILLIPS-VAN HEUSEN PVH (1)	303.8	11	-15	12.4	9.3	106	11	0.2	1.3	1.36	1.10	0.85	0.99	2.0	10.0			
POLO RALPH LAUREN RL (3)	2354.2	24	8	NA	19.6	261	13	1.0	1.0	0.00	0.61	1.70	1.97	4.1	14.8			
REEBOK INTERNATIONAL R8K	1333.8	23	-15	-8.9	15.0	193	14	0.5	1.0	0.00	1.40	1.62	1.76	2.8	15.0			
RUSSELL RML	417.4	13	-15	32.1	2.8	87	NM	0.4	0.9	1.23	0.44	1.25	1.53	9.8	12.0			
VF VFC	4206.6	38	5	-0.1	10.9	183	17	0.7	1.6	2.53	2.27	2.66	2.94	4.8	9.0			

(B) APPLIANCES & HOME FURNISHINGS

GROUP AVERAGE	3805.9	32	32	18.2	13.0	417	38	0.9	1.6	1.11	1.72	1.45	1.78	5.2	16.2			
BED BATH & BEYOND 88BY (2)	9417.5	32	45	32.2	20.2	1009	51	3.6	1.8	0.00	0.59	0.72	0.88	1.1	25.0			
BEST BUY 8BY (2)	15053.3	71	141	NM	19.0	738	39	0.9	1.6	0.00	1.86	2.25	2.64	3.0	20.0			
CIRCUIT CITY GROUP CC (2)	3651.5	18	53	2.4a	2.3	153	70	0.4	1.5	0.40	0.73	0.78	0.92	14.1	15.0			
FURNITURE BRANOS INTERNATIONAL F8N	1328.0	26	25	24.2	9.5	213	22	0.7	1.4	0.00	2.15	1.29	1.96	6.6	15.0			
HARMAN INTERNATIONAL INOS. HAR (6)	1365.4	43	17	-9.3	6.8	308	48	0.8	2.6	0.23	2.06	0.96*	1.99	1.0	17.0			
KIMBALL INTERNATIONAL K8AL8 (6)	540.7	14	-2	NA	2.4	122	53	0.4	3.4	4.50	1.20	0.42*	0.48	6.3	10.0			
LA-Z-BOY LZB (4)	1276.0	21	33	8.0	6.0	183	30	0.6	1.5	1.71	1.13	1.08	1.39	7.2	13.0			
LEGGITT & PLATT LEG	4251.9	22	14	12.2	10.6	228	22	1.0	1.6	2.22	1.32	0.94	1.16	6.0	14.5			
LINENS 'N THINGS LIN	974.5	24	-13	43.0	11.4	199	18	0.6	0.9	0.00	1.60	1.34	1.55	5.8	20.0			
MAYTAG MYG	2220.7	29	-10	17.4	29.1	963	34	0.5	1.0	2.49	2.44	1.60	2.02	6.4	17.5			
PIER 1 IMPORTS PIR (2)	1375.4	14	40	18.3	16.0	256	16	0.9	1.2	1.11	0.97	0.85	0.98	3.1	14.0			
RADIOSHACK RSH	5216.4	29	-32	NM	32.2	665	21	1.1	1.3	0.76	1.84	1.50	1.68	3.6	15.0			

ESTMENT OUTLOOK SCOREBOARD

EARNINGS PER SHARE

													2002 ESTIMATES FROM ANALYSTS				
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
IRLPOOL	WHR	4400.7	66	38	28.9	5.5	305	55	0.4	1.3	2.07	5.20	5.41	5.79	5.2	9.5	B+
LIAMS-SONOMA	WSM (1)	2211.2	39	94	22.7	11.2	493	44	1.1	1.5	0.00	0.99	1.19	1.44	2.8	21.5	8
BEVERAGES																	
POUP AVERAGE		32919.2	42	-4	14.6	20.0	525	33	2.1	9.5	1.15	1.79	1.94	2.20	5.0	12.4	
HEUSER-BUSCH	BUD	38111.7	43	-5	10.2	39.5	893	23	3.0	2.1	1.67	1.69	1.88	2.09	1.4	11.0	A
DWN-FORMAN	BF B (4)	4158.1	61	-8	8.5	19.6	355	18	2.1	2.6	2.30	3.40	3.34	3.74	1.3	7.0	A
KA-COLA	KO	116785.2	47	23	11.0	29.8	1054	35	5.8	2.3	1.53	0.88	1.57	1.78	1.1	13.0	A-
KA-COLA ENTERPRISES	CCE	7766.6	17	-8	18.9	2.1	238	103	0.5	61.0	0.92	0.54	0.02	0.20	25.0	14.3	8
STELLATION BRANDOS	STZ (2)	1628.8	38	29	22.0	13.5	194	14	0.6	0.8	0.00	2.61	3.05	3.53	0.9	15.0	8+
JRS (A&OLPH)	RKY	2078.8	57	-29	27.2	12.2	213	18	0.9	1.8	1.44	2.93	3.08	3.23	5.9	10.5	B
PSI BOTTLING GROUP	P8G	6311.9	22	12	14.9	17.1	364	22	0.8	3.2	0.18	0.76	0.94	1.12	2.2	15.0	NR
PSICO	PEP	86512.8	49	-2	26.0	26.6	889	32	3.4	2.3	1.19	1.48	1.66	1.90	2.1	13.0	A
PERSONAL CARE																	
POUP AVERAGE		22473.4	39	6	8.2	38.9	1754	34	2.1	2.5	1.31	0.97	1.21	1.85	2.2	11.1	
ON PRODUCTS	AVP	11277.9	48	0	14.4	NM	NM	22	1.9	1.8	1.59	2.02	2.09	2.32	0.9	13.0	A
IROX	CLX (6)	9191.4	40	11	2.1	17.3	522	31	2.3	2.9	2.13	1.64	1.36*	1.79	1.1	10.0	A
GATE-PALMOLIVE	CL	32198.1	58	-10	14.6	138.2	6927	31	3.4	2.5	1.23	1.70	1.91	2.17	1.4	12.2	A
L DL		1661.4	18	59	NM	27.9	1251	43	1.0	2.1	0.91	-0.12	0.85	0.95	2.1	10.0	NR
LAB ECL		4780.9	37	13	16.7	24.0	554	24	2.0	1.8	1.39	1.58	1.47	1.61	5.0	14.5	A-
TEE LAUDER	EL (6)	7933.4	33	-24	12.6	16.1	560	28	1.7	2.2	0.60	1.20	1.17*	1.42	2.1	13.0	NR
LETTE G		34498.5	33	-9	0.0	26.6	1531	55	3.8	3.3	1.99	0.77	0.99	1.12	4.5	10.0	A-
CTER & GAMBLE	PG (6)	100357.2	77	-1	-3.0	22.1	934	38	2.6	3.7	1.96	2.47	2.07*	3.45	0.9	10.0	A
/LON REV		362.4	7	41	NM	NM	NM	NM	0.3	NM	0.00	-2.54	-0.98	NA	NA	7.0	NR
TOBACCO																	
POUP AVERAGE		23021.4	37	14	2.2	35.8	427	11	1.3	1.3	4.57	2.82	3.22	3.37	1.6	9.5	
ION DMN	(6)	276.3	6	13	-24.1	7.5	67	9	0.2	0.9	3.23	0.40	0.56*	0.62	1.6	13.0	8-
LIP MORRIS	MO	102377.5	47	7	10.1	42.3	515	12	1.5	1.2	4.92	3.75	4.05	4.51	1.6	10.0	A
REYNOLDS TOBACCO HOLDINGS	RJR	5526.3	57	18	13.7	4.9	67	14	0.7	1.4	6.10	3.46	4.47	4.82	3.1	9.0	NR
IVERSAL UVV	(6)	988.5	37	5	9.2	20.6	176	9	0.3	0.9	3.49	3.77	4.08*	3.76	1.1	10.3	B+
T UST		5938.3	36	28	2.2	103.5	1311	13	3.8	2.4	5.13	2.70	2.96	3.14	0.6	5.0	A+
CONTAINERS & PACKAGING																	
POUP AVERAGE		2001.4	29	29	14.9	32.2	441	20	0.6	2.6	1.12	1.04	1.18	1.52	25.3	8.7	
GLASS, METAL & PLASTIC																	
POUP AVERAGE		902.3	25	38	33.4	92.8	1008	6	0.2	1.3	0.22	0.18	1.69	2.19	26.2	8.0	
L BLL		1887.6	69	49	60.6	-17.6	400	NM	0.5	1.9	0.88	2.14	3.58	4.34	4.6	10.0	8
DWN CORK & SEAL	CCK	126.9	1	86	NM	-14.9	6	NM	0.0	NM	0.00	-1.40	-0.67	0.25	88.0	7.0	B-
ENS-ILLINOIS OI		1204.1	8	45	NM	17.7	72	3	0.2	0.8	0.00	-2.00	1.26	1.44	8.3	8.0	8-
GAN HOLDINGS	SLGN	390.8	22	143	6.2	385.9	3552	9	0.2	1.2	0.00	1.97	2.59	2.72	3.7	7.0	NR
PAPER																	
POUP AVERAGE		2441.1	30	25	10.8	7.9	214	23	0.8	3.1	1.48	1.38	0.97	1.25	25.0	9.0	
MIS BMS		2654.1	50	50	5.9	15.7	310	20	1.2	1.9	1.99	2.44	2.59	2.84	1.8	10.0	A
CKAGING CORP. OF AMERICA	PKG	1846.6	18	9	11.2	21.8	247	12	1.0	NA	0.00	1.43	1.04	0.95	20.0	NA	NR
CTIV PTV		2784.9	18	41	16.5	7.7	170	22	0.9	1.6	0.00	0.70	1.01	1.16	4.3	11.0	NR
TLATCH PCH		787.9	28	-17	NM	-8.5	106	NM	0.4	NM	2.15	-1.16	-2.23	-1.39	26.6	4.0	8-
CK-TENN RKT	(9)	472.4	14	90	17.0	7.5	117	16	0.3	1.6	2.13	-0.46	0.90*	1.51	2.7	10.0	NR
ALD AIR SEE		3843.0	46	50	44.9	7.5	466	31	1.2	2.2	0.00	1.93	1.69	1.89	6.4	12.5	NR
MURFIT-STONE CONTAINER	SSCC	3924.3	16	8	6.9	4.9	157	31	0.5	8.0	0.00	0.93	0.27	0.50	108.0	7.5	NR
NOCO PRODUCTS	SON	2350.9	25	14	0.5	12.5	291	23	0.9	2.0	3.25	1.66	1.56	1.75	5.7	8.0	8+
MPLE-INLANO TIN		2819.8	57	7	8.2	6.4	149	23	0.7	2.7	2.24	3.83	1.99	2.17	35.5	10.6	8
STVACO W	(10)	2926.8	29	-2	-14.1	3.8	125	33	0.7	4.7	3.08	2.53	0.87*	1.16	38.8	7.0	8
DISCOUNT & FASHION RETAILING																	
POUP AVERAGE		11489.1	26	39	13.7	9.5	312	28	1.0	1.9	0.41	0.91	1.15	1.43	18.4	15.9	
ERCROMBIE & FITCH	ANF (1)	2387.3	24	20	55.5	32.7	468	15	1.8	0.8	0.00	1.55	1.57	1.84	4.9	20.0	B
BERTO-CULVER	ACV (9)	2468.4	44	2	6.4	15.0	335	23	1.0	2.1	0.76	1.83	1.91*	2.13	0.9	11.0	A+
IAZON.COM	AMZN	4208.4	11	-27	NM	NM	NM	NM	1.4	NM	0.00	-4.02	-0.61	-0.33	21.2	39.7	NR
NTAYLOR STORES	ANN (1)	795.6	27	9	50.2	5.4	130	24	0.6	1.5	0.00	1.76	1.24	1.50	7.3	15.0	8
TOZONE	AZO (8)	7363.2	67	136	4.9	22.6	850	44	1.5	2.9	0.00	2.00	1.54*	2.88	2.8	15.0	8+
RNES & NOBLE	BKS (1)	1987.2	31	17	NM	-6.7	248	NM	0.4	1.7	0.00	-0.81	1.12	1.62	8.0	16.0	NR
LOTS 8LI	(1)	1069.9	9	-12	3.7	4.5	116	25	0.3	2.3	0.00	0.87	0.27	0.40	25.0	15.0	8
S WHOLESALE CLUB	8J (1)	3291.6	45	17	25.7	12.3	501	42	0.6	1.3	0.00	1.77	2.01	2.30	2.2	17.0	NR
ROERS GROUP	8GP (1)	1558.1	19	65	5.1	6.4	185	29	0.5	1.1	0.00	0.92	1.22	1.42	2.8	15.0	NR
RLINGTON COAT FACTORY	8CF (5)	741.4	17	-12	22.9	10.2	117	11	0.3	0.7	0.12	1.62	1.80	NA	NA	13.0	8+
W COMPUTER CENTERS	CDWC	4654.7	55	96	47.0	23.3	642	29	1.2	1.3	0.00	1.79	1.89	2.08	1.4	23.0	NR
ARMING SHOPPES	CHRS (1)	504.5	5	-18	NM	6.3	98	16	0.3	1.4	0.00	0.49	0.24	0.38	7.9	15.0	8-
STCO WHOLESALE	COST (8)	18467.7	41	2	15.2	12.3	378	32	0.5	2.1	0.00	1.35	1.29*	1.48	3.4	15.0	B
K AUTO	CAO (1)	235.0	8	118	NM	-17.6	199	NM	0.2	0.6	0.00	0.18	0.91	1.21	8.3	15.0	NR
LARO'S	DDS (1)	1385.4	17	40	-15.7	1.1	54	46	0.2	4.9	0.97	1.06	0.42	0.79	44.3	8.0	A
LLAR TREE STORES	DLTR	3145.8	28	14	NA	19.7	554	28	1.7	1.1	0.00	1.08	1.06	1.29	3.9	24.0	B+

EARNINGS PER SHARE

													2002 ESTIMATES FROM ANALYSTS				
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	
FAMILY DOLLAR STORES	FOO (8)	5126.7	30	39	25.7	19.8	535	27	1.4	1.4	0.81	1.00	1.10*	1.23	2.4	19.5	
FEDERATED DEPARTMENT STORES	FO (1)	7129.0	37	6	NM	8.9	124	14	0.4	1.1	0.00	-0.90	2.89	3.40	7.4	12.0	
FOOT LOCKER	Z (1)	2254.9	16	4	-13.5	10.3	210	20	0.5	0.9	0.00	0.77	0.9B	1.14	1.8	17.5	
FOOTSTAR	FTS	615.7	31	-38	14.9a	-5.0	207	NM	0.3	0.8	0.00	2.97	2.56	3.15	5.4	14.5	
GAP	GPS (1)	11399.6	13	-48	21.0	9.8	373	40	0.8	3.3	0.67	1.00	0.27	0.49	24.5	15.0	
HOME DEPOT	HD (1)	109123.0	47	2	26.8	16.1	629	39	2.2	1.8	0.43	1.10	1.27	1.50	2.0	20.0	
INSIGHT ENTERPRISES	NSIT	826.7	20	11	50.9	15.3	264	17	0.4	0.7	0.00	1.35	1.01	1.11	7.2	30.0	
INTIMATE BRANDS	IBI (1)	7064.3	14	-4	16.4	44.2	992	22	1.4	1.4	1.95	0.87	0.63	0.78	10.3	16.0	
KMART	KM (1)	3040.3	6	15	NM	-1.6	52	NM	0.1	3.8	0.00	-0.48	0.17	0.39	59.0	9.5	
KOHL'S	KSS (1)	22697.9	68	11	34.1	17.3	893	53	3.3	2.1	0.00	1.10	1.38	1.68	1.8	23.8	
LANOS' ENO	LE (1)	1338.5	46	83	-7.0	16.1	409	26	0.9	1.6	0.00	1.14	1.89	2.19	12.3	15.0	
LIBERTY MEDIA	LMC.A	34058.0	13	-3	NA	-14.5	109	NM	16.9	NM	0.00	0.58	-0.45	-0.32	31.3	15.0	
LIMITED	LTO (1)	5966.1	14	-18	6.4	18.0	250	14	0.6	1.6	2.16	0.96	0.63	0.80	7.5	13.5	
LOWE'S	LOW (1)	35058.7	45	104	23.9	14.7	546	37	1.6	1.8	0.18	1.05	1.25	1.50	2.0	20.0	
MAY DEPARTMENT STORES	MAY (1)	10723.5	36	9	8.6	19.3	272	15	0.7	1.7	2.62	2.62	2.27	2.58	4.3	9.5	
MEN'S WEARHOUSE	MW (1)	785.1	19	-30	29.6	13.2	159	12	0.6	1.0	0.00	2.00	1.03	1.25	4.8	19.0	
MICHAELS STORES	MIK (1)	1946.6	30	127	NM	10.7	257	25	0.8	0.9	0.00	1.17	1.43	1.69	1.2	23.0	
NEIMAN MARCUS GROUP	NMG.A (7)	1400.2	29	-17	NA	8.5	145	17	0.5	0.9	0.00	2.75	2.26*	2.03	9.9	15.0	
NORDSTROM	JWN (1)	2537.2	19	4	-3.5	8.0	200	25	0.4	2.0	1.90	0.78	0.80	0.99	14.1	12.0	
OFFICE DEPOT	ODP	4840.4	16	127	-26.6	-0.4	272	NM	0.4	1.4	0.00	0.16	0.75	0.86	4.7	15.0	
OFFICEMAX	OMX (1)	347.8	3	7	NM	-16.3	38	NM	0.1	NM	0.00	-1.20	-0.52	-0.25	36.0	12.0	
PAYLESS SHOESOURCE	PSS (1)	1231.3	55	-22	18.3	18.9	249	13	0.4	1.5	0.00	5.16	3.31	4.58	11.6	11.0	
PC CONNECTION	PCCC	384.0	16	51	NA	7.8	266	34	0.3	1.5	0.00	1.23	0.36	0.49	16.3	30.0	
PENNEY (J.C.)	JCP (1)	6664.4	25	133	NM	-6.2	117	NM	0.2	14.9	1.97	-2.29	0.34	0.91	19.8	5.0	
PEP BOYS-MANNY, MOE & JACK	PBY (1)	852.8	17	358	NM	5.5	140	25	0.4	2.1	1.63	-1.04	0.68	0.83	2.4	11.5	
PETSMART	PETM (1)	979.6	9	205	NM	-6.2	335	NM	0.4	1.7	0.00	-0.30	0.26	0.40	0.0	20.0	
ROSS STORES	ROST (1)	2257.2	28	67	22.8	28.6	430	15	0.8	1.0	0.60	1.82	1.81	2.05	2.0	15.0	
SAKS	SKS (1)	1164.6	8	-18	-7.4	-0.7	52	NM	0.2	5.9	0.00	0.53	0.14	0.39	51.3	10.0	
SEARS, ROEBUCK S		14658.8	46	31	5.2	11.1	239	22	0.4	1.3	2.02	3.88	4.06	4.38	4.3	9.0	
SHERWIN-WILLIAMS	SHW	4325.8	28	6	-47.7	-2.0	297	NM	0.9	1.7	2.07	0.10	1.67	1.91	4.7	10.0	
SHOPKO STORES	SKO (1)	267.9	9	86	NM	-8.2	41	NM	0.1	0.9	0.00	-1.72	0.71	0.93	12.9	15.0	
SPIEGEL	SPGLA	597.8	5	5	NM	5.8	75	13	0.2	1.6	0.00	0.95	0.19	0.65	12.3	15.0	
SPORTS AUTHORITY	TSA (1)	182.7	6	372	-31.6	6.9	131	20	0.1	1.7	0.00	0.21	0.33	0.43	11.6	10.0	
STAPLES	SPLS (1)	8112.9	18	49	NA	3.1	421	135	0.7	1.6	0.00	0.13	0.63	0.75	2.7	18.0	
TALBOTS	TLB (1)	2036.7	33	-28	18.0	23.7	379	16	1.2	1.1	0.98	1.80	2.00	2.27	2.6	15.0	
TARGET	TGT (1)	33849.8	38	16	27.5	17.7	473	27	0.9	1.7	0.59	1.38	1.48	1.68	3.0	15.0	
TIFFANY	TIF (1)	4206.9	29	-9	31.4	18.1	434	25	2.6	1.5	0.56	1.26	1.10	1.18	4.2	18.0	
TIJX	TJX (1)	10567.5	38	36	29.7	41.5	842	20	1.0	1.3	0.48	1.86	1.91	2.21	2.3	15.0	
TOYS 'R' US	TOY (1)	4231.0	22	29	5.3	4.9	129	28	0.4	1.9	0.00	1.88	0.95	1.34	4.5	12.0	
VALUE CITY DEPARTMENT STORES	VCD (1)	208.3	6	15	NM	-18.7	91	NM	0.1	NM	0.00	-3.03	-0.33	0.13	476.9	13.0	
WAL-MART STORES	WMT (1)	245808.3	55	4	20.4	18.9	717	38	1.2	2.6	0.51	1.40	1.49	1.71	1.8	14.0	
ZALE	ZLC (7)	1235.9	36	22	13.3	8.5	141	16	0.6	1.0	0.00	3.11	2.36*	2.85	4.9	15.0	

9 ELECTRICAL & ELECTRONICS

INDUSTRY AVERAGE	12068.6	29	-13	31.8	-0.2	358	44	3.1	3.0	0.51	1.25	-0.58	0.73	44.4	19.8	
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(A) ELECTRICAL PRODUCTS

GROUP AVERAGE	5031.5	39	-14	7.1	10.0	211	21	1.0	1.7	2.76	2.55	1.85	2.37	11.9	11.9	
AMERICAN POWER CONVERSION APCC	2688.8	14	11	14.8	10.3	227	22	1.8	1.3	0.00	0.83	0.69	0.79	11.4	15.0	B
COOPER INDUSTRIES CBE	3826.4	41	-11	9.5	14.3	191	13	0.9	1.5	3.43	3.80	2.75	3.12	13.8	10.0	A
EMERSON ELECTRIC EMR (9)	23135.3	54	-31	10.1b	16.9	378	23	1.5	2.1	2.87	3.30	2.40*	2.72	5.2	11.0	A
HUBBELL HUB.B	1595.9	27	3	1.3	11.8	208	18	1.2	1.9	4.85	2.25	1.47	1.53	24.8	10.0	B
NATIONAL SERVICE INDUSTRIES NSI (8)	656.3	16	-38	NM	4.2	102	NM	0.3	NM	4.02	0.42	-0.37*	1.47	8.2	12.5	A
ROCKWELL INTERNATIONAL ROK (9)	30294.7	17	-65	-15.0	7.8	189	24	0.7	2.3	4.00	1.81	0.68*	0.71	9.9	10.5	B
SMITH (A.O.) AOS	425.1	18	5	29.1	4.9	93	19	0.4	1.9	2.91	1.76	0.84	1.23	20.3	11.5	B
SPX SPW	4894.5	122	12	0.1	9.7	303	27	1.4	1.3	0.00	6.25	6.36	7.40	1.9	15.0	B

(B) ELECTRONICS

GROUP AVERAGE	18162.2	36	-10	-21.0	-10.4	421	30	3.9	3.6	0.27	0.40	0.06	1.05	25.5	20.6
AVAYA AV (9)	3259.8	11	10	NM	-43.3	67B.	NM	0.5	NM	0.00	-1.39	-1.33*	0.59	13.6	14.0
HARRIS HRS (6)	2104.7	32	4	-21.0	6.7	192	29	1.1	5.7	0.63	0.34	0.32*	1.34	6.7	17.5
HUGHES ELECTRONICS GMH	18727.2	14	-37	NA	-5.7	195	NM	2.3	NM	0.00	-0.34	-0.50	-0.40	25.0	32.5
L-3 COMMUNICATIONS HOLDINGS LLL	3247.2	83	B	NA	9.0	287	31	1.5	1.5	0.00	2.37	2.90	3.50	1.4	19.4
MOTOROLA MOT	36813.7	17	-18	NA	18.0	258	NM	1.1	NM	0.97	0.58	-0.31	0.16	100.0	15.0
QUALCOMM QCOM (9)	44820.3	59	-29	NM	-10.9	917	NM	16.7	NM	0.00	0.85	-0.71*	1.11	6.3	25.0

(C) INSTRUMENTS

GROUP AVERAGE	5939.6	35	-24	18.6	12.2	371	41	2.4	1.7	0.27	1.49	0.97	0.94	12.5	17.7
AGILENT TECHNOLOGIES A (10)	12571.5	27	-50	4.1b	-7.1	223	NM	1.5	NM	0.00	1.48	0.89*	0.90	23.3	18.5
APPLIED BIOSYSTEMS GROUP ABI (6)	7014.9	33	-65	NA	18.3	658	37	4.3	1.9	0.51	0.86	0.96*	0.94	2.1	18.0
BECKMAN COULTER BEC	2551.7	42	0	12.5	29.5	553	19	1.3	1.5	0.81	2.03	2.22	2.52	2.0	13.0
DANAHER DHR	8382.4	59	-14	19.1a	16.0	380	25	2.2	1.6	0.14	2.23	2.36	2.60	5.0	15.5
KLA-TENCOR KLAC (6)	9308.6	50	49	32.6	24.0	51B	23	4.2	1.0	0.00	1.32	1.93*	1.03	13.6	25.0

EARNINGS PER SHARE

													2002 ESTIMATES FROM ANALYSTS				
PANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	LONG-TERM GROWTH RATE %			S&P EQUITY RANKING	
													CONSENSUS	VARIATION %			
PANY STOCK SYMBOL (FY)																	
INELMER PKI	2800.7	28	-47	24.9	11.2	345	31	2.0	1.4	1.01	0.84	1.17	1.28	3.1	16.5	B+	
RONIX TEK (5)	2069.9	22	-33	26.9	11.7	202	18	1.8	2.7	0.00	1.46	0.56	0.91	20.9	15.0	B	
OYNE TER	4901.4	28	-25	52.0	2.5	292	127	2.4	NM	0.00	2.86	-0.51	-0.97	39.2	23.0	B	
IMO ELECTRON TMO	3855.4	22	-27	23.0	3.4	172	52	1.8	1.6	0.00	0.36	0.89	1.03	2.9	15.0	B-	
SEMICONDUCTORS & OTHER COMPONENTS																	
UP AVERAGE	14409.1	23	-11	47.6	-4.8	380	57	3.7	3.9	0.06	1.01	-1.75	0.20	65.0	22.2		
MFG. ACTM	22.2	1	-92	18.9	10.4	12	NM	0.0	0.1	0.00	1.62	0.67	0.17	223.5	25.0	NR	
INCEO MICRO DEVICES AMD	4634.8	14	-2	NM	3.7	128	33	1.1	NM	0.00	2.95	-0.13	-0.36	66.7	15.0	B-	
IE SYSTEMS AGR.A (9)	8437.1	5	NA	NA	NM	343	NM	2.1	NM	0.00	-0.07	-3.46*	-0.61	11.5	23.5	NR	
RA ALTR	8766.7	23	-14	41.7	17.9	784	47	8.4	2.4	0.00	1.19	0.33	0.25	24.0	29.0	B	
DR TECHNOLOGY AMKR	2513.5	16	0	27.6	-23.9	219	NM	1.4	NM	0.00	1.02	-1.96	-1.03	56.3	25.0	NR	
HENOL APH	2005.0	47	21	37.2	91.4	1828	20	1.7	1.4	0.00	2.52	1.99	2.21	13.1	16.5	B+	
LOG DEVICES ADI (10)	15355.5	43	-17	15.1	12.5	540	46	6.7	1.8	0.00	1.59	0.93*	0.61	13.1	25.0	B	
EL ATML	3840.7	8	-29	3.2	-19.6	251	NM	2.2	NM	0.00	0.55	-0.06	-0.06	166.7	25.0	B	
AVX (3)	3631.5	21	27	47.3	19.5	242	13	1.8	6.4	0.72	3.22	0.24	0.48	37.5	13.5	B+	
CHMARK ELECTRONICS BHE	375.6	19	-15	3.4	-13.2	108	NM	0.3	1.0	0.00	1.06	0.74	0.67	16.4	25.0	B+	
LOCOM BRGM	10997.5	44	-48	NM	-97.8	338	NM	10.2	NM	0.00	-3.13	-0.33	-0.12	100.0	40.0	NR	
EXANT SYSTEMS CNXT (9)	3753.2	15	-3	NM	-81.9	212	NM	3.5	NM	0.00	-0.90	-5.94*	-1.41	6.4	25.0	NR	
RESS SEMICONDUCTOR CY	2768.9	23	17	75.8	-32.2	328	NM	2.8	NM	0.00	2.03	0.01	0.02	600.0	20.0	B-	
CHILLO SEMICONDUCTOR INTL. FCS	2443.7	25	70	NA	8.3	298	37	1.6	6.5	0.00	2.69	0.19	0.30	16.7	20.0	NR	
L INTC	219213.9	33	9	18.7	8.3	611	74	7.8	3.9	0.24	1.51	0.47	0.57	12.3	18.0	A	
L CIRCUIT JBL (8)	5035.4	26	4	13.0	8.4	356	45	1.2	1.5	0.00	0.78	0.59*	0.69	13.0	30.0	B	
JNIPHASE JDSU (6)	13383.2	10	-76	NM	NM	140	NM	4.8	NM	0.00	-1.27	-51.40*	-0.05	80.0	25.0	C	
ET KEM (3)	1447.6	17	12	70.4	21.3	163	8	1.5	5.4	0.00	4.00	0.20	0.44	34.1	15.8	B	
AR TECHNOLOGY LLTC (6)	12976.8	41	-11	31.6	21.6	757	37	15.1	1.3	0.39	0.88	1.29*	0.60	6.7	25.0	A	
OGIC LSI	5958.3	16	-5	7.0	-25.3	222	NM	2.8	NM	0.00	0.70	-0.56	-0.42	47.6	20.0	B-	
UFACTURERS SERVICES MSV	163.0	5	-24	NM	-47.4	117	NM	0.1	0.5	0.00	-0.88	0.49	0.48	14.6	20.0	NR	
IM INTEGRATED PRODUCTS MXIM (6)	17758.4	55	15	10.5	14.3	916	69	12.7	2.4	0.00	1.04	0.93*	0.77	5.2	25.0	B+	
ION TECHNOLOGY MU (8)	16252.5	27	-23	NM	-7.3	228	NM	4.1	NM	0.00	2.63	-0.88*	-0.80	42.5	20.0	B-	
EX MOLX (6)	5600.0	29	-19	5.2	9.1	308	35	2.6	1.9	0.35	1.12	1.03*	0.63	4.8	15.0	A	
ONAL SEMICONDUCTOR NSM (5)	5236.8	30	50	244.0	2.7	302	151	2.9	NM	0.00	1.30	-0.96	0.31	93.6	19.0	B-	
EMICONDUCTOR ONNN	284.0	2	-69	NA	NM	NM	NM	0.2	NM	0.00	0.49	-1.18	-0.78	12.8	17.0	NR	
MINA-SCI SANM (9)	6867.3	21	-44	14.4	2.2	373	178	1.7	5.9	0.00	0.67	0.12*	0.38	15.8	30.0	B	
CTRON SLR (8)	9675.5	15	-57	NM	-2.4	188	NM	0.5	NM	0.00	0.80	-0.19*	0.42	19.1	25.0	B+	
IS INSTRUMENTS TXN	55517.0	32	-32	266.3	5.0	481	100	5.9	20.0	0.27	1.73	0.08	0.05	220.0	20.0	B+	
MAS & BETTS TNB	1186.8	20	26	NM	-15.6	147	NM	0.8	NM	0.00	-3.33	-0.19	1.30	42.3	15.0	B	
AY INTERTECHNOLOGY VSH	2927.2	18	22	74.8	10.3	155	13	1.5	1.4	0.00	3.77	0.90	0.46	43.5	15.0	B	
IX XLNX (3)	12061.7	36	-22	-26.7	-18.7	681	NM	8.8	6.8	0.00	0.10	0.20	0.37	18.9	26.5	B	
FOOD																	
UP AVERAGE	7268.0	29	27	7.0	19.4	447	24	0.8	2.0	1.42	0.90	1.41	1.73	5.1	12.2		
FOOD DISTRIBUTION																	
UP AVERAGE	3777.1	26	54	3.5	8.8	295	29	0.3	1.4	0.95	0.26	1.40	1.78	2.7	15.4		
NING FLM	1149.3	26	119	NA	-3.2	226	NM	0.1	0.6	0.31	-3.15	1.98	2.51	1.6	23.0	B-	
INTERNATIONAL MULTIFOODS IMC (2)	429.1	23	12	NM	6.1	164	27	0.2	2.2	0.00	1.12	0.88	1.83	6.0	12.0	B-	
H FINCH NAFC	290.2	25	113	-6.0	9.9	145	15	0.1	1.2	1.45	1.38	1.76	2.02	0.5	12.0	B	
PERFORMANCE FOOD GROUP PFGC	1487.7	34	33	16.8	8.4	327	32	0.5	1.6	0.00	0.91	1.11	1.41	4.3	19.5	B+	
ERVALU SVU (2)	3023.8	23	63	-16.9	3.5	161	45	0.1	1.2	2.47	0.62	1.76	1.90	1.6	11.0	B+	
CO SYY (6)	16282.3	25	-18	20.3	28.3	747	27	0.7	1.9	1.46	0.68	0.88*	1.00	2.0	15.0	A+	
FOOD PROCESSING																	
UP AVERAGE	8528.6	32	15	10.3	27.3	532	22	1.1	2.2	1.65	1.40	1.61	1.87	4.9	10.7		
HER DANIELS MIOLANO ADM (6)	10177.4	15	8	1.7	6.3	158	25	0.5	2.8	1.30	0.45	0.58*	0.83	8.4	9.5	B+	
IPBELL SOUP CPB (7)	11987.8	29	-15	4.0	NM	NM	20	1.8	2.4	2.15	1.65	1.55*	1.31	1.5	8.0	A-	
AGRA FOODS CAG (5)	12338.0	23	-12	-0.4	17.6	306	17	0.5	1.8	4.09	1.33	1.40	1.55	3.9	9.0	A	
N PRODUCTS INTERNATIONAL CPO	1150.3	33	12	17.8	6.5	125	19	0.6	1.8	1.23	1.35	1.63	2.13	7.5	11.0	NR	
N FOODS DF (5)	1643.4	46	49	3.4	8.6	230	27	0.4	1.5	1.97	2.07	2.58	3.05	13.8	12.0	B+	
MONTE FOODS DLM (6)	441.7	8	17	NM	135.5	1825	14	0.3	1.1	0.00	2.50	0.76*	0.84	1.2	10.0	NR	
E FOOD DOL	1315.3	24	44	-4.9	-4.9	217	NM	0.3	1.4	1.70	1.21	1.70	1.90	0.0	10.0	B	
IVERS FOODS FLO	831.6	42	-47	NA	-4.8	133	NM	0.5	6.0	NA	-2.11	0.77	1.52	30.3	9.0	NR	
ERAL MILLS GIS (5)	14045.0	49	11	13.5	NM	NM	21	2.0	2.0	2.23	2.28	2.18	2.90	1.0	11.3	B+	
HZ (H.J.) HNZ (4)	13347.4	38	-20	14.7	34.0	972	27	1.4	2.0	4.25	1.41	2.39	2.68	4.9	8.0	B+	
SHEY FOODS HSY	8871.8	65	2	8.4	29.6	715	25	2.0	2.7	1.85	2.42	2.73	3.01	1.3	9.0	A	
MEL FOODS HRL (10)	3478.0	25	34	16.4	18.3	349	19	0.8	1.8	1.56	1.20	1.30*	1.56	0.0	10.5	A	
ERSTATE BAKERIES IBC (5)	1243.2	25	75	-3.4	11.1	312	29	0.4	3.3	1.14	1.13	1.51	1.78	2.3	5.0	B+	
LOGG K	11987.7	29	12	3.8	51.7	1375	27	1.5	2.5	3.42	1.45	1.30	1.43	2.8	9.0	B+	
FT FOODS KFT	57463.2	33	NA	8.1	7.5	247	29	1.8	1.9	1.57	1.38	1.19	1.45	2.1	15.0	NR	
ORMICK MKC (11)	2973.8	43	19	38.7	34.1	699	21	1.3	1.8	1.95	1.98	2.19	2.43	2.9	11.0	A	
PRIM'S PRIOE CHX (9)	581.8	14	81	0.8	11.0	153	14	0.3	NA	0.42	1.27	1.02*	1.40	10.0	NA	B	
A LEE SLE (6)	17139.1	22	-11	18.9	126.2	1362	11	1.0	1.3	2.74	1.27	1.87*	1.39	1.4	9.0	A-	
THFIELD FOODS SFD (4)	2640.5	25	66	35.9	23.0	241	11	0.4	1.0	0.00	2.03	1.95	2.00	7.0	12.5	B+	

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2002 ESTIMATES FROM ANALYSTS				
												2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %
STARBUCKS	SBUX (9)	6782.8	18	-20	27.3	13.2	493	39	2.6	1.5	0.00	0.25	0.46*	0.53	1.9	25.0
SUIZA FOODS	SZA	1690.5	60	25	19.3	16.7	243	16	0.3	1.5	0.00	3.68	4.00	4.60	2.8	10.0
TYSON FOODS	TSN (9)	2658.6	12	-6	-17.4	2.6	79	30	0.3	3.0	1.33	0.67	0.40*	1.02	3.9	10.0
WRIGLEY (WM.) JR.	WY	11368.2	51	6	9.9	28.7	928	32	4.9	3.0	1.50	1.45	1.60	1.77	1.1	10.5
(C) FOOD RETAILING																
GROUP AVERAGE		6463.2	25	39	-2.5	9.3	361	26	0.3	1.9	1.20	0.14	0.94	1.38	7.2	13.6
ALBERTSON'S	ABS (1)	13625.4	34	27	0.6	7.6	239	32	0.4	1.5	2.26	1.83	1.89	2.15	5.1	12.0
GREAT ATLANTIC & PACIFIC TEA	GAP (2)	918.4	24	242	NM	-4.5	117	NM	0.1	NM	0.00	-0.65	0.00	0.99	37.4	11.8
KROGER	KR (1)	20306.6	25	-6	NA	34.7	631	19	0.4	1.1	0.00	1.04	1.52	1.76	2.8	15.0
PATHMARK STORES	PTMK (1)	728.4	24	47	NA	-57.5	181	NM	0.2	2.0	0.00	-4.34	0.81	1.01	2.0	15.0
RUDDICK	RDK (9)	720.1	16	36	NM	-0.2	162	NM	0.3	NM	2.32	1.10	-0.02*	1.10	5.5	12.0
SAFEWAY	SWY	22507.3	45	-29	19.9	19.2	360	19	0.7	1.1	0.00	2.13	2.58	2.92	1.0	15.5
7-ELEVEN	SE	1283.9	12	40	-0.9	66.1	954	16	0.2	1.2	0.00	0.97	0.78	0.86	4.7	13.0
SMART & FINAL	SMF	299.4	10	20	-25.0	5.0	109	22	0.2	NA	0.00	0.38	0.54	0.63	NA	NA
WHOLE FOODS MARKET	WFMI (9)	2315.8	43	40	20.7	14.9	605	42	1.0	2.2	0.00	0.53	1.02*	1.34	1.5	19.0
WINN-DIXIE STORES	WIN (6)	1927.0	14	-29	-30.4	7.7	255	33	0.2	4.5	7.44	-1.57	0.32*	1.03	4.9	9.5
11 FUEL																
INDUSTRY AVERAGE		14392.2	37	-10	17.7	21.7	212	18	1.1	1.2	1.54	3.29	3.85	2.54	23.8	13.8
(A) COAL, OIL & GAS																
GROUP AVERAGE		17642.7	39	0	28.3	26.0	199	13	0.8	1.3	1.97	4.25	4.76	2.97	25.5	11.4
AMERADIA HESS	AHC	5153.1	58	-20	12.7	24.9	107	4	0.4	0.6	2.07	11.38	11.31	6.84	13.0	8.1
ANADARKO PETROLEUM	APC	12959.4	52	-27	NA	16.9	178	11	1.4	0.6	0.58	4.25	5.23	2.70	39.6	15.5
APACHE	APA	5731.6	46	-34	43.0	20.1	140	7	1.9	0.5	0.87	5.73	5.95	3.46	28.0	15.0
ARCH COAL	ACI	1046.4	20	42	NM	1.5	184	74	0.7	12.5	1.15	-0.33	0.16	2.13	8.0	10.0
ASHLAND	ASH (9)	2965.2	43	19	35.4a	18.2	133	7	0.4	1.0	2.58	4.10	5.77*	4.40	8.0	7.6
BURLINGTON RESOURCES	BR	7055.0	35	-30	16.2	25.5	191	8	1.9	1.1	1.57	3.12	3.09	0.77	101.3	10.0
CHEVRONTEXACO	CVX	54617.4	85	1	18.9	24.3	237	10	1.2	2.0	3.29	7.97	6.99	4.96	9.3	6.0
CONOCO	COC	17116.6	27	-5	11.4	30.1	258	9	0.5	1.1	2.78	3.00	2.99	2.15	7.9	8.0
CONSOL ENERGY	CNX (6)	1731.3	22	-21	10.6a	52.8	544	10	0.7	0.8	5.09	1.35	2.33*	2.28	43.0	12.0
DEVON ENERGY	OVN	4333.6	34	-44	30.2	23.1	115	5	1.4	0.5	0.58	5.50	5.02	2.12	50.5	14.0
EOG RESOURCES	EOG	4043.6	35	-36	39.2	34.0	262	7	2.1	0.9	0.46	3.24	3.32	1.06	61.3	11.8
EXXON MOBIL	XOM	255816.0	37	-14	11.5a	23.5	347	15	1.3	2.2	2.46	2.28	2.29	1.94	10.8	7.5
FRONTIER OIL	FTO	438.6	16	134	NM	65.6	241	4	0.2	0.3	1.24	1.34	4.89	1.41	9.9	12.8
KERR-McGEE	KMG	5263.8	53	-22	30.7a	25.7	161	6	1.3	1.6	3.43	8.37	5.52	3.31	45.9	6.0
MITCHELL ENERGY & DEVELOPMENT	MND	2533.5	50	-18	81.7a	37.2	307	8	1.2	0.6	1.05	5.13	5.49	3.85	20.8	15.0
MURPHY OIL	MUR	3258.2	72	19	24.7	26.5	218	8	0.7	0.8	2.09	6.75	5.66	3.54	21.2	16.0
OCCIDENTAL PETROLEUM	OXY	9339.8	25	3	34.6	30.0	159	5	0.6	0.7	4.00	4.26	3.96	2.12	19.8	9.3
PENNZOIL-QUAKER STATE	PZL	1032.8	13	1	NM	1.9	129	72	0.5	0.7	0.77	0.07	0.66	0.92	14.1	27.0
PHILLIPS PETROLEUM	P	21184.3	56	-2	10.2	15.4	147	7	1.0	1.1	2.59	7.26	6.27	4.42	14.3	8.0
SUNOCO	SUN	2873.6	37	9	NM	30.6	160	6	0.2	0.9	2.74	4.70	5.37	3.96	9.3	7.8
TESORO PETROLEUM	TSO	393.7	13	8	NM	13.2	52	5	0.1	0.4	0.00	1.75	2.23	1.66	16.9	15.6
ULTRAMAR DIAMOND	SHAMROCK UOS	3566.1	48	55	NM	37.8	201	6	0.2	0.5	1.04	5.11	7.98	4.77	14.5	12.3
UNOCAL	UCL	8012.7	33	-15	26.9	25.1	250	10	1.0	1.0	2.43	2.93	3.08	1.68	30.4	10.5
USX-MARATHON GROUP	MRO	8474.4	27	-1	-12.1	16.3	142	9	0.3	0.6	3.36	1.39	4.94	2.71	18.5	9.5
VALERO ENERGY	VLO	2126.3	35	-6	83.6	29.7	104	4	0.1	0.4	1.14	5.60	8.46	5.09	20.4	10.3
(B) PETROLEUM SERVICES																
GROUP AVERAGE		7004.8	32	-35	-3.5	11.9	241	31	1.7	1.0	0.56	0.91	1.79	1.57	20.0	19.7
BAKER HUGHES	BHI	11073.8	33	-21	-22.3	8.3	339	41	2.1	1.6	0.70	0.31	1.29	1.36	11.0	16.0
BJ SERVICES	BJ (9)	4567.1	28	-19	32.1	25.7	336	13	2.1	0.7	0.00	0.70	2.09*	1.45	11.0	20.0
COOPER CAMERON	CAM	1977.1	37	-45	-20.0	6.6	221	36	1.3	0.8	0.00	0.50	1.98	1.95	8.7	23.5
FMC TECHNOLOGIES	FTI	819.7	13	NA	NA	10.6	211	NA	0.4	NA	0.00	NA	0.82	0.93	6.5	NA
HALLIBURTON	HAL	9193.5	21	-41	-20.3	8.5	200	24	0.7	1.1	2.33	0.42	1.31	1.34	13.4	15.0
NABORS INDUSTRIES	NBR	4437.0	32	-47	3.2	19.7	250	15	2.1	0.6	0.00	0.89	2.29	1.67	15.6	22.0
NOBLE AFFILIATES	NBL	1850.8	33	-29	20.4	22.5	179	8	1.1	0.8	0.49	3.38	2.74	0.62	96.8	15.0
SCHLUMBERGER	SLB	27640.3	48	-40	-1.9	7.0	334	48	2.2	1.7	1.56	1.27	1.45	1.70	12.4	20.0
SMITH INTERNATIONAL	SI	2235.8	45	-39	-1.3	15.3	244	16	0.7	0.8	0.00	1.45	3.05	2.78	15.5	19.0
TRANSOCEAN SECO	FOREX RIG	9021.0	28	-38	-21.6	1.9	83	45	3.8	1.4	0.42	0.50	0.84	1.62	19.1	25.0
WEATHERFORD INTERNATIONAL	WFT	4236.5	33	-29	NM	4.5	249	61	1.9	0.9	0.00	-0.36	1.79	1.88	9.6	21.0
12 HEALTH CARE																
INDUSTRY AVERAGE		26449.3	41	4	15.9	13.5	567	58	3.1	1.6	0.46	0.53	1.50	1.87	9.5	17.2
(A) DRUG DISTRIBUTION																
GROUP AVERAGE		8934.2	32	31	14.4	8.7	476	116	0.5	1.6	0.48	-0.02	1.17	1.54	13.9	17.0
AMERISOURCEBERGEN	ABC (9)	3153.6	60	18	20.9	4.0	111	28	0.2	1.4	0.17	1.90	2.10*	2.90	2.4	20.0
CARDINAL HEALTH	CAH (6)	30804.7	68	3	22.0	16.1	543	34	0.6	1.8	0.15	1.60	1.88*	2.62	0.8	20.0
CAREMARK RX	CMX	3386.9	15	11	23.4	NM	NM	23	0.6	0.8	0.00	0.43	0.71	0.91	1.1	27.0
CVS	CVS	10531.4	27	-55	17.5	15.7	237	15	0.5	1.2	0.85	1.83	1.56	1.70	7.7	14.0
D&K HEALTHCARE RESOURCES	OKWD (6)	330.3	46	241	22.3a	7.8	231	21	0.2	1.4	0.22	1.84	2.02*	2.63	1.5	16.5
GENTIVA HEALTH SERVICES	GTV	517.2	20	53	NM	6.6	85	12	0.4	2.1	0.00	5.05	0.64	0.89	21.4	15.0

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COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2002 ESTIMATES FROM ANALYSTS					S&P EQUITY RATING
												2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	
LONGS DRUG STORES	LDG (1)	866.7	23	-5	-5.6	4.8	124	25	0.2	1.7	2.44	1.19	1.25	1.34	3.7	11.0	A-
McKESSEON	MCK (3)	10658.4	37	4	NM	0.4	289	932	0.2	1.4	0.64	-0.15	1.44	1.77	2.8	18.0	NR
OMNICARE	OCR	1997.3	21	-1	-3.9	5.4	177	33	1.0	1.4	0.42	0.53	0.95	1.27	9.5	16.0	A-
RITE AID	RAD (2)	2419.8	5	97	NM	NM	2287	NM	0.2	NM	0.00	-5.15	-0.59	-0.10	100.0	12.5	8-
WALGREEN	WAG (8)	33609.7	33	-21	18.6	17.7	672	38	1.4	2.3	0.44	0.76	0.86*	0.99	2.0	17.0	A+
(B) DRUGS & RESEARCH																	
GROUP AVERAGE		74726.6	57	-13	21.7	16.9	1038	59	8.7	2.0	0.93	1.18	1.72	1.96	3.2	19.6	
ABBOTT LABORATORIES	ABT	85373.0	55	14	10.9	19.5	985	51	5.5	2.3	1.53	1.78	1.88	2.25	0.4	13.0	A+
ALLERGAN	AGN	9945.1	75	-22	29.3	22.3	1069	49	5.9	1.9	0.48	1.61	1.95	2.33	0.9	20.0	8+
AMERICAN HOME PRODUCTS	AHP	79222.4	60	-5	NA	-74.6	2504	NM	5.7	1.8	1.53	-0.69	2.18	2.51	1.2	15.0	8
AMGEN	AMGN	69452.6	66	4	14.8	22.9	1360	62	18.1	2.9	0.00	1.05	1.19	1.43	2.8	19.0	8+
BRISTOL-MYERS SQUIBB	BM	104133.9	54	-27	13.8	46.8	1048	23	5.5	1.9	2.05	2.05	2.41	2.59	2.7	12.0	A
FOREST LABORATORIES	FRX (3)	12573.5	71	7	NM	20.6	894	45	9.2	1.4	0.00	1.18	1.72	2.13	1.9	30.0	8+
GENENTECH	DNA	30287.8	57	-30	NM	2.2	522	239	15.3	3.0	0.00	-0.03	0.75	0.91	3.3	25.5	NR
GENZYME GENERAL	GENZ	11589.8	55	21	63.0	-2.9	518	NM	12.6	2.0	0.00	0.68	1.18	1.48	3.4	23.0	8-
IMMUNEX	IMNX	14705.0	27	-34	NM	8.8	727	84	15.3	2.2	0.00	0.28	0.29	0.30	16.7	43.0	8-
LILLY (ELI)	LLY	92938.2	83	-11	17.6	40.6	1262	30	8.0	2.4	1.35	2.79	2.76	2.75	2.9	12.4	A-
MERCK	MRK	154129.6	68	-28	16.6	46.8	1004	22	3.3	2.0	2.07	2.90	3.14	3.42	2.6	11.0	A+
PFIZER	PFE	272277.8	43	-6	10.0	38.1	1441	38	8.7	1.7	1.02	0.59	1.31	1.59	1.3	19.0	A+
PHARMACIA	PHA	57249.9	44	-27	NA	13.2	478	36	3.0	1.3	1.22	0.75	1.74	1.92	2.1	20.0	8
SCHERING-PLOUGH	SGP	52294.1	36	-37	19.1	33.0	727	22	5.4	1.8	1.79	1.64	1.63	1.87	3.2	12.0	A+
(C) HEALTH-CARE SERVICES																	
GROUP AVERAGE		4990.5	37	0	8.0	12.2	298	35	0.9	1.3	0.01	0.14	1.57	2.06	13.5	16.9	
AETNA	AET	4467.6	31	-24	NA	-4.6	44	NM	0.2	NM	0.13	NA	-1.81	-0.24	229.2	13.5	NR
ANTHEM	ATH	5323.0	51	NA	NA	15.0	245	NA	0.5	1.1	0.00	NA	2.98	3.48	1.2	15.0	NR
BEVERLY ENTERPRISES	BEV	948.8	9	11	NM	-14.6	170	NM	0.4	1.0	0.00	-0.53	0.46	0.57	8.8	20.0	C
COMMUNITY HEALTH SYSTEMS	CYH	2214.3	26	-27	NM	4.8	279	60	1.4	2.1	0.00	0.14	0.49	0.67	4.5	25.0	NR
COVENTRY HEALTH CARE	CVH	1375.2	21	-21	NM	12.2	206	17	0.5	1.2	0.00	0.93	1.22	1.44	3.5	15.0	8-
OAVITA	DVA	1912.8	23	32	-16.4	24.9	400	17	1.2	1.3	0.00	0.20	1.10	1.28	4.7	16.0	NR
EXPRESS SCRIPTS	ESRX	3257.6	41	-20	NM	13.6	399	30	0.4	1.1	0.00	-0.10	1.55	1.97	4.1	25.0	8+
GENESIS HEALTH VENTURES	GHVE (9)	1021.2	21	NA	NM	NM	NM	NM	0.4	NM	0.00	-18.55	-1.42	1.59	NA	12.0	NR
HCA	HCA	19970.8	39	-12	-34.9	17.6	406	24	1.1	1.4	0.21	0.39	1.92	2.22	2.7	15.0	8
HEALTH MANAGEMENT ASSOCS.	HMA (9)	4782.0	20	-6	16.1	15.6	381	26	2.5	1.7	0.00	0.68	0.76*	0.93	1.1	15.0	8+
HEALTH NET	HNT	2471.3	20	-24	44.2	6.9	223	33	0.3	0.9	0.00	1.33	1.58	1.83	2.2	14.0	NR
HEALTHSOUTH	HRC	5774.7	15	-10	5.1	5.7	155	28	1.3	1.2	0.00	0.71	0.82	0.93	1.1	15.0	8
HUMANA	HUM	2123.4	13	-18	66.7	7.5	145	19	0.2	1.2	0.00	0.54	0.69	0.87	6.9	15.0	C
LABORATORY CORP. OF AMERICA	HLOGS. LH	5401.6	77	-13	NM	15.7	521	33	2.6	1.2	0.00	1.61	2.62	3.44	2.3	25.0	8-
MANOR CARE	HCR	2391.0	23	13	-23.3	10.3	226	22	0.9	1.4	0.00	0.38	1.14	1.33	3.8	15.0	NR
MIO ATLANTIC MEDICAL SERVICES	MME	983.7	20	2	NM	19.2	360	16	0.6	1.0	0.00	1.00	1.35	1.57	3.2	15.0	8
OXFORD HEALTH PLANS	OHP	2647.6	29	-27	16.9	57.1	522	10	0.6	0.7	0.00	2.24	2.84	3.13	3.8	15.0	8-
PACIFICARE HEALTH SYSTEMS	PHSY	606.0	18	17	18.7	2.7	29	11	0.1	0.7	0.00	4.58	1.69	1.83	29.5	15.0	8
QUEST DIAGNOSTICS	DGX	5889.3	62	-13	NM	13.0	474	37	1.7	1.3	0.00	1.11	1.89	2.48	1.6	25.0	NR
SIERRA HEALTH SERVICES	SIE	249.5	9	136	NM	1.1	265	224	0.2	1.1	0.00	-7.37	0.54	0.63	7.9	14.5	C
TENET HEALTHCARE	THC (5)	19608.4	60	35	NM	14.2	371	26	1.6	1.4	0.00	2.08	2.94	3.46	2.0	15.0	8
TRIAO HOSPITALS	TRI	1997.3	28	-15	-49.9	-0.5	117	NM	0.9	2.9	0.00	0.13	0.53	0.76	7.9	18.3	NR
TRIGON HEALTHCARE	TGH	2313.6	65	-17	10.2a	9.9	239	26	0.8	1.1	0.00	2.90	4.07	4.69	0.9	15.0	NR
UNITEDHEALTH GROUP	UNH	22009.8	71	16	26.0	23.6	592	27	1.0	1.6	0.04	2.19	2.76	3.24	0.9	16.0	A
UNIVERSAL HEALTH SERVICES	UHS	2508.6	42	-25	16.4	14.8	314	22	0.9	1.0	0.00	1.50	2.04	2.36	3.0	20.0	8+
WELLPOINT HEALTH NETWORKS	WLP	7502.8	118	2	16.3	19.5	371	20	0.7	1.3	0.00	5.29	6.07	7.03	1.4	15.0	8+
(D) MEDICAL PRODUCTS																	
GROUP AVERAGE		34751.0	42	10	23.8	16.3	682	43	4.1	2.1	0.97	1.21	1.36	1.60	2.5	14.7	
BAUSCH & LOMB	BO	1782.3	33	-18	7.5	2.2	178	79	1.0	3.1	3.13	1.49	0.97	1.30	8.5	11.0	8-
BAXTER INTERNATIONAL	BAX	30685.1	52	18	8.0	28.2	858	31	4.1	2.0	1.12	1.24	1.75	2.02	1.0	15.0	8
BECTON, DICKINSON	BDX (9)	8756.9	34	-2	8.7	19.6	399	21	2.3	1.7	1.15	1.49	1.63*	1.80	1.1	12.0	A
BOSTON SCIENTIFIC	BSX	10728.9	27	94	20.9	-3.2	576	NM	4.1	2.3	0.00	0.91	0.78	0.96	5.2	15.0	8
GUIDANT	GDT	14859.1	49	-10	79.3	25.6	1065	42	5.6	2.0	0.00	1.21	1.66	1.91	1.6	15.0	NR
JOHNSON & JOHNSON	JNJ	177328.8	58	11	13.2	23.0	747	33	5.6	2.4	1.24	1.70	1.90	2.20	1.4	13.0	A+
MEOTRONIC	MDT (4)	57185.9	47	-22	14.9	14.2	991	71	9.7	2.2	0.49	0.85	1.21	1.42	1.4	17.5	A
OWENS & MINOR	OMI	636.6	19	6	41.8	12.5	279	24	0.2	1.3	1.49	0.94	1.03	1.17	1.7	14.0	8
STRYKER	SYK	10795.3	55	9	20.3	24.9	1046	43	4.3	2.1	0.15	1.10	1.34	1.61	0.6	20.0	8+
13 HOUSING & REAL ESTATE																	
INDUSTRY AVERAGE		2747.3	39	25	21.7	12.4	172	19	0.8	1.0	1.70	2.94	3.93	4.13	14.0	13.3	
(A) BUILDING MATERIALS																	
GROUP AVERAGE		2681.1	32	12	0.7	8.1	170	28	0.7	1.3	1.74	1.86	2.19	2.54	9.5	12.5	
AMERICAN STANOARD	ASD	4559.1	64	29	NM	NM	NM	14	0.6	1.0	0.00	4.36	4.54	4.90	2.3	13.5	NR
HUGHES SUPPLY	HUG (1)	632.9	27	50	-1.6	5.0	107	21	0.2	1.0	1.27	1.97	1.86	2.18	7.8	15.0	A-
LAFARGE NORTH AMERICA	LAF	2644.7	37	55	14.8	10.9	136	13	0.8	1.4	1.64	3.51	3.39	4.05	8.9	7.5	8+
LENNOX INTERNATIONAL	LII	537.9	9	20	-10.1	0.9	76	72	0.2	1.3	4.09	1.05	0.60	0.73	17.8	12.0	NR



Webb - Acct# 82004162341

Olivia Webb - Acct# 82004162341
38 years old. Customer since 1992.
Checking balance \$1,200.



Webb - Acct# 82004162341
38 years old. Customer since 1992.
Checking balance \$1,200.
Married. One child.
Annual salary \$105,000.
Household income \$195,000.
Total household savings \$237,200.

Olivia Webb - Acct# 82004162341
38 years old. Customer since 1992. Checking balance \$1,200.
Married. To her college sweetheart, Chris.
One child. Cute kid named Robb.
A Director of Marketing for tech company.
Annual salary \$105,000. Household income \$195,000.
Total household savings \$237,200.
\$110,000 in brokerage balances; \$125,000 in retirement
plan; \$1,200 in checking.
\$1,000 in sister's new catering business.
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EARNINGS PER SHARE

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	2002 ESTIMATES FROM ANALYSTS		
														CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %
MARTIN MARIETTA MATERIALS	MLM	2057.0	43	0	8.8	10.1	206	20	1.2	1.4	1.32	2.39	2.32	2.79	2.9	13.0
MASCO	MAS	9605.2	21	-19	12.1	2.8	234	81	1.2	1.2	2.58	1.31	1.13	1.34	10.5	15.0
NORTEK	NTK	229.7	21	-12	13.2	11.2	86	8	0.1	0.6	0.00	3.70	2.27	3.45	22.6	15.0
PPG INDUSTRIES	PPG	9053.5	54	16	-2.4	13.9	292	21	1.1	2.5	3.12	3.57	2.67	2.87	10.1	8.0
RPM	RPM (5)	1412.6	14	61	-6.5	10.6	211	20	0.7	1.8	3.62	0.62	0.93	1.04	3.9	8.5
TECUMSEH PRODUCTS	TECUA	861.9	47	11	-9.6	5.3	89	17	0.6	1.1	2.75	3.44	4.45	NA	NA	10.0
USG	USG	222.5	5	-77	NM	NM	45	NM	0.1	0.5	0.00	-5.62	1.26	2.77	37.2	8.0
VALSPAR	VAL (10)	1952.8	39	23	-7.2	7.9	298	36	1.0	2.6	1.37	2.00	1.10*	2.37	0.8	14.0
VULCAN MATERIALS	VMC	4684.9	46	-3	4.8	13.5	297	22	1.6	1.4	1.95	2.16	2.23	2.69	2.6	15.0
WATSCO	WSO	342.6	13	12	-1.8a	4.6	106	23	0.3	0.7	0.78	0.69	1.05	1.17	1.7	18.0
YORK INTERNATIONAL	YRK	1419.3	37	19	-5.0	8.4	189	23	0.4	0.8	1.64	2.78	2.99	3.15	4.1	14.5

(B) CONSTRUCTION & REAL ESTATE

GROUP AVERAGE	2813.5	45	37	44.5	16.1	174	10	1.0	0.5	1.67	4.02	5.68	5.62	18.2	14.4
BEAZER HOMES USA 8ZH (9)	573.5	67	68	67.5	21.5	163	8	0.3	0.5	0.00	5.05	8.26*	8.38	9.4	16.0
CENTEX CTX (3)	2735.6	45	20	26.6	18.1	145	8	0.4	0.6	0.35	4.65	5.75	5.88	8.3	12.5
CHAMPION ENTERPRISES CH8	579.2	12	339	NM	-58.2	212	NM	0.4	NM	0.00	-3.12	-0.45	0.33	136.4	25.0
EQUITY OFFICE PROPERTIES TRUST EOP	12334.8	30	-9	NA	4.8	117	18	4.2	NA	6.71	1.53	1.76	2.21	11.8	NA
EQUITY RESIDENTIAL PTYS. TRUST EQR	7827.4	29	5	24.1a	6.6	177	22	3.6	NA	5.98	1.69	1.43	1.63	20.3	NA
HORTON (O.R.) DHI (9)	2120.8	28	27	33.4	20.4	170	8	0.5	0.6	0.71	2.53	3.31*	3.48	8.9	15.0
KB HOME KBH (11)	1368.8	34	0	NM	20.1	138	6	0.3	0.5	0.89	5.24	5.25	4.99	14.6	12.5
LENNAR LEN (11)	2378.2	37	3	29.3	24.4	159	7	0.4	0.4	0.13	3.64	5.49	5.47	9.0	15.5
M.O.C. HOLOINGS MDC	863.9	33	19	50.4	24.4	142	6	0.4	0.4	0.78	4.65	5.57	4.83	14.9	13.5
NVR NVR	1372.1	182	47	77.4	72.6	460	8	0.5	0.6	0.00	14.98	23.78	22.79	5.8	12.5
PULTE HOMES PHM	2312.8	39	-7	42.9	12.4	107	7	0.5	0.6	0.41	5.18	5.82	6.11	11.8	11.3
RYLAND GROUP RYL	795.2	60	47	62.9	23.5	152	7	0.3	0.6	0.27	5.92	8.97	8.24	12.0	11.0
SIMON PROPERTY GROUP SPG	5053.3	29	20	2.6	5.6	213	28	2.4	NA	7.27	1.13	1.31	1.64	1.8	NA
STANDARD PACIFIC SPF	624.3	21	-9	90.6	22.1	114	5	0.4	0.5	1.51	3.39	3.57	2.96	2.4	13.0
TOLL BROTHERS TOL (10)	1261.9	36	-11	26.1	23.2	144	7	0.6	0.5	0.00	3.90	5.35	5.37	6.2	15.0

14 LEISURE TIME INDUSTRIES

INDUSTRY AVERAGE	5299.7	25	59	13.0	5.8	250	19	1.2	1.7	0.95	0.54	1.29	1.47	14.7	14.0
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(A) EATING PLACES

GROUP AVERAGE	6978.1	31	14	11.5	15.5	278	19	1.1	1.3	0.25	1.72	1.77	2.04	1.5	14.8
BRINKER INTERNATIONAL EAT (6)	2749.9	28	-1	27.6	16.6	304	19	1.1	1.2	0.00	1.17	1.42*	1.62	1.2	16.5
CBRL GROUP CBRL (7)	1421.4	26	42	-11.3	6.0	164	28	0.7	2.0	0.08	1.02	0.87*	1.52	1.3	15.0
OARDEN RESTAURANTS DRI (5)	3582.7	31	34	NM	18.9	335	19	0.9	1.1	0.26	1.59	1.81	2.05	2.0	15.0
JACK IN THE BOX J8X (9)	1010.6	26	-12	23.4	21.9	263	12	0.6	0.7	0.00	2.55	2.11*	2.18	0.5	17.0
McDONALD'S MCD	34500.1	27	-21	7.6	17.8	353	19	2.4	1.7	0.84	1.46	1.36	1.50	2.0	11.8
OUTBACK STEAKHOUSE OSI	2384.1	31	20	17.0	14.6	264	18	1.2	1.2	0.00	1.78	1.78	2.08	2.4	15.0
TRICOR GLOBAL RESTAURANTS YUM	6927.7	47	44	NA	NM	NM	16	1.0	1.1	0.00	2.77	3.17	3.46	1.2	14.0
WENON'S INTERNATIONAL WEN	3248.4	28	8	4.7	12.7	265	19	1.4	1.2	0.84	1.44	1.66	1.89	1.6	13.8

(B) ENTERTAINMENT

GROUP AVERAGE	3067.0	21	216	17.5	1.6	152	18	1.1	2.1	0.04	-1.24	0.89	1.04	18.6	14.6
BLDCKBUSTER 8BI	4631.4	26	214	NM	-4.5	81	NM	0.9	1.4	0.30	-0.43	0.92	1.15	5.2	20.0
HARRAH'S ENTERTAINMENT HET	3616.6	32	22	NM	-0.6	276	NM	1.0	1.1	0.00	-0.09	1.88	2.05	2.0	15.0
HDLLYWOOD ENTERTAINMENT HLYW	735.1	15	1302	NM	NM	NM	NM	0.6	5.2	0.00	-11.48	0.57	1.09	0.9	5.0
MANDALAY RESORT GROUP M8G (1)	1552.6	22	-2	11.5	9.9	147	16	0.6	1.1	0.00	1.50	1.29	1.20	15.8	15.0
METRO-GOLDWYN-MAYER MGM	4271.0	18	9	NM	-3.4	175	NM	3.3	NM	0.00	0.24	-0.05	0.20	70.0	21.0
MGM MIRAGE MGG	4144.6	26	-7	13.2	8.7	167	20	1.0	1.4	0.00	1.13	1.27	1.22	13.9	15.0
PARK PLACE ENTERTAINMENT PPE	2517.5	8	-30	27.8	-0.4	67	NM	0.5	2.3	0.00	0.46	0.32	0.36	22.2	11.5

(C) HOTEL & MOTEL

GROUP AVERAGE	6036.4	25	-13	11.6	11.7	204	17	1.1	1.5	1.48	1.53	1.02	1.05	22.4	15.7
HILTON HOTELS HLT	3656.1	10	-6	5.0	12.7	223	16	1.1	1.5	0.81	0.73	0.44	0.52	32.7	15.0
MARRIOTT INTERNATIONAL MAR	9085.9	38	-11	17.1	13.8	250	19	0.9	1.6	0.69	1.89	1.59	1.74	19.0	15.0
STARWOOD HOTELS & RESORTS HOT	5367.2	27	-23	12.9	8.5	138	17	1.3	1.6	2.95	1.96	1.03	0.90	15.6	17.0

(D) OTHER LEISURE

GROUP AVERAGE	5299.0	24	12	13.0	0.4	298	20	1.3	1.8	1.90	0.55	1.27	1.44	19.8	12.4
AMERICAN GREETINGS AM (2)	828.7	13	38	NM	-22.9	90	NM	0.3	1.5	3.07	1.46	1.03	1.42	14.1	8.5
BRUNSWICK 8C	1728.2	20	20	8.8	11.4	152	13	0.5	2.1	2.54	2.28	0.96	1.00	15.0	10.0
CARNIVAL CCL (11)	15304.6	26	15	13.2	15.3	234	15	3.5	1.2	1.61	1.60	1.56	1.37	12.4	13.5
EASTMAN KODAK EK	8808.6	30	-23	11.4	14.4	266	19	0.7	1.9	5.95	4.59	2.29	1.77	11.9	7.0
FLEETWOOD ENTERPRISES FLE (4)	411.1	13	20	NM	-96.0	149	NM	0.1	NM	1.27	-8.33	0.01	1.32	73.5	NA
HARLEY-DAVIDSDN HDI	15917.7	53	32	24.4	25.1	965	39	4.9	1.9	0.23	1.13	1.41	1.62	1.9	20.0
HASBRO HAS	2840.7	16	55	NM	-13.4	221	NM	0.9	4.0	0.73	0.82	0.41	0.73	11.0	10.0
MATTEL MAT	7920.0	18	27	-20.9	17.3	492	28	1.7	1.9	0.27	0.40	0.80	0.97	4.1	12.0
POLARIS INDUSTRIES PII	1216.0	53	33	12.0	40.0	556	14	0.8	1.0	1.89	3.50	3.85	4.32	0.9	14.3
ROYAL CARIBBEAN CRUISES RCL	2975.2	16	41	18.4	8.4	78	9	1.0	1.1	3.35	2.31	1.30	0.72	34.7	11.0
TRANS WORLD ENTERTAINMENT TWMC (1)	338.0	8	10	36.8	5.2	79	18	0.2	1.2	0.00	0.83	0.38	0.62	38.7	17.5

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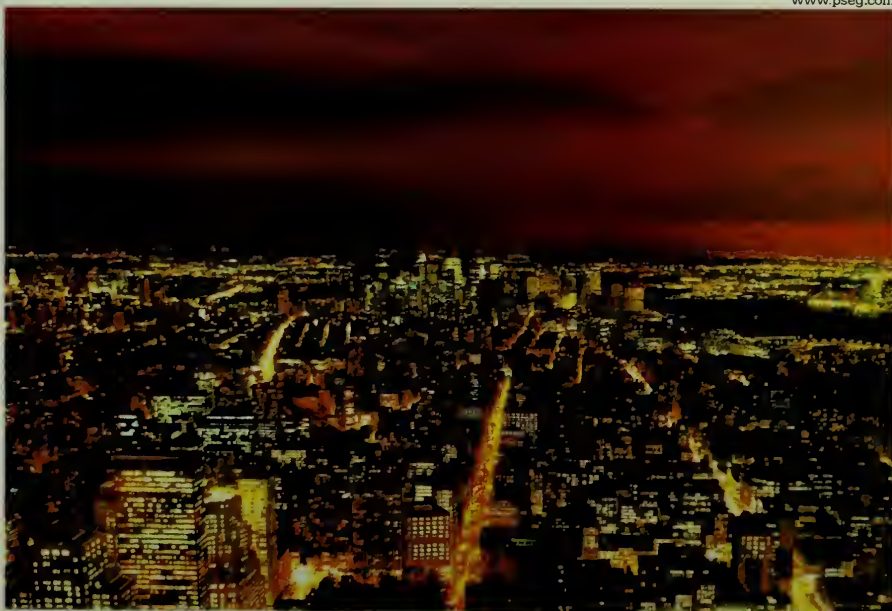
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EARNINGS PER SHARE

														2002 ESTIMATES FROM ANALYSTS			
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	
15 MANUFACTURING																	
INDUSTRY AVERAGE		7682.2	35	8	5.3	4.7	265	42	0.9	1.6	1.39	2.13	1.71	2.08	50.9	12.4	
(A) GENERAL MANUFACTURING																	
GROUP AVERAGE		7070.4	45	6	8.4	10.2	302	22	1.0	1.5	1.87	2.47	2.37	2.63	6.2	12.1	
AVERY DENNISON AVY		5932.0	54	-2	14.4	27.2	638	21	1.6	1.8	2.45	2.84	2.48	2.62	1.9	12.0	
CARLISLE CSL		1015.6	34	-22	14.7	5.2	189	36	0.6	2.1	2.50	3.14	1.61	2.23	10.8	10.0	
ENERGIZER HOLDINGS ENR (9)		1696.8	19	-13	NM	-5.5	237	NM	1.0	NM	0.00	1.87	-0.42*	1.05	7.6	12.5	
FORTUNE BRANDS FO		5980.8	39	31	NM	-5.6	288	NM	1.1	1.7	2.55	-0.88	2.37	2.63	2.7	10.0	
HARSCO HSC		1334.0	33	35	9.6	12.7	193	15	0.6	1.1	3.00	2.42	2.35	2.70	0.0	13.0	
HILLENBRAND INDUSTRIES HB (11)		3288.8	53	2	4.8	15.9	336	21	1.5	1.7	1.60	2.44	2.86	3.18	2.5	11.0	
JOHNSON CONTROLS JCI (9)		6958.0	80	53	21.1	16.7	275	16	0.4	1.3	1.66	5.09	5.11*	5.08	5.7	12.0	
MINNESOTA MINING & MFG. MMM		44925.1	115	-5	6.6	23.5	729	32	2.8	2.2	2.09	4.64	4.36	4.75	2.5	12.0	
NEWELL RUBBERMAID NWL		6840.9	26	13	10.9a	11.9	283	24	1.0	1.6	3.27	1.57	1.20	1.38	2.9	13.0	
PARKER HANNIFIN PH (6)		4814.1	41	-7	5.2	10.8	187	17	0.8	1.1	1.75	3.31	2.99*	2.16	6.9	12.0	
TELEFLEX TFX		1647.9	42	-4	15.5	15.1	217	14	0.9	1.0	1.60	2.83	2.86	2.95	4.8	15.0	
TOWER AUTOMOTIVE TWR		411.1	9	-5	-18.9	-5.5	54	NM	0.2	1.0	0.00	0.34	0.70	0.84	26.2	12.5	
(B) MACHINE & HAND TOOLS																	
GROUP AVERAGE		2017.0	34	18	6.9	13.0	261	23	0.8	1.4	1.67	2.62	1.90	2.27	10.1	12.4	
BLACK & DECKER BDK		2978.9	37	-6	18.8	22.5	387	17	0.7	1.2	1.30	3.34	2.21	2.61	15.7	14.0	
KENNAMETAL KMT (6)		1230.7	40	37	-10.2	7.0	154	22	0.7	1.8	1.70	1.71	1.75*	2.30	4.8	13.0	
SNAP-ON SNA		1812.6	31	12	-0.6	6.4	222	34	0.8	1.7	3.07	2.10	1.83	2.03	4.4	10.0	
STANLEY WORKS SWK		3566.9	42	34	19.5	23.9	430	18	1.4	1.4	2.30	2.22	2.31	2.59	3.5	12.8	
TEREX TEX		496.0	18	14	NM	4.9	112	23	0.3	1.1	0.00	3.72	1.40	1.84	22.3	12.0	
(C) SPECIAL MACHINERY																	
GROUP AVERAGE		10667.2	34	6	2.6	1.3	225	63	1.0	1.6	1.25	2.14	1.48	1.90	85.2	12.9	
AGCO AG		1004.3	14	15	-60.4	1.0	120	116	0.4	3.3	0.00	0.06	0.39	0.77	19.5	11.0	
APPLIED MATERIALS AMAT (10)		32438.5	40	4	34.6a	10.2	426	44	4.4	1.8	0.00	2.40	0.91*	0.21	71.4	25.0	
BRIGGS & STRATTON BGG (6)		834.2	39	-13	0.7	9.3	209	23	0.6	2.7	3.21	5.97	2.21*	2.65	1.5	6.5	
CATERPILLAR CAT		16277.2	47	0	-3.7	15.4	277	18	0.8	1.5	2.95	3.02	2.60	3.10	10.7	12.0	
CRANE CR		1414.1	24	-17	10.4a	15.2	221	15	0.9	1.4	1.69	2.02	1.69	1.59	1.9	10.0	
CUMMINS CUM		1388.8	36	-4	-52.8	-15.3	117	NM	0.2	NM	3.31	0.20	-0.45	1.44	27.8	8.0	
DEERE DE (10)		9397.7	40	-13	NM	-1.5	217	NM	0.7	NM	2.20	2.06	-0.27*	0.61	37.7	10.0	
DOVER DOV		7461.2	37	-9	15.3	14.2	294	21	1.5	2.7	1.47	2.61	0.99	1.41	10.6	14.0	
FLOWSERVE FLS		930.3	25	15	-30.6	0.6	321	492	0.5	1.2	0.00	0.40	1.43	2.13	5.2	14.5	
FMC FMC		1671.7	54	-25	7.3	-40.9	274	NM	0.4	1.2	0.00	5.62	4.48	4.95	21.4	10.0	
ILLINOIS TOOL WORKS ITW		18692.0	61	3	14.8	13.9	317	23	1.9	1.6	1.43	3.15	2.64	2.92	3.4	14.5	
INGERSOLL-RAND IR		7037.1	42	0	12.5	6.5	182	27	0.8	1.7	1.62	3.36	2.04	2.52	15.9	12.0	
ITT INDUSTRIES ITT		4310.6	49	27	52.3	21.7	333	16	0.9	1.3	1.22	2.94	3.09	3.32	2.1	12.0	
LAM RESEARCH LRCX (6)		2749.9	22	51	NM	19.1	389	22	1.4	0.8	0.00	1.53	1.07*	-0.02	1250.0	25.0	
McDERMOTT INTERNATIONAL MDR		691.9	11	5	NM	-0.3	86	NM	0.4	NA	0.00	-0.37	0.59	1.25	4.8	NA	
MILACRON MZ		466.6	14	-13	9.8	1.7	104	61	0.4	NM	0.29	2.06	-0.52	0.27	233.3	9.0	
PENTAIR PNR		1737.1	35	46	1.7	5.2	163	32	0.7	1.4	2.03	1.68	1.94	2.31	4.3	13.0	
TIMKEN TKR		848.6	14	-6	-23.4	-4.6	93	NM	0.3	NM	3.67	0.76	0.00	0.30	36.7	10.0	
TORO TTC (10)		572.2	46	25	4.3	14.1	163	12	0.4	0.9	1.05	3.47	3.85	4.00	0.0	13.0	
TYCO INTERNATIONAL TYC (9)		113808.7	59	6	51.8a	14.5	356	23	3.2	1.2	0.09	2.64	2.55*	3.64	3.0	20.0	
UNOVA UNA		279.0	5	33	NM	-72.9	65	NM	0.2	NM	0.00	-0.71	-0.25	0.50	28.0	8.5	
(D) TEXTILES																	
GROUP AVERAGE		928.0	15	11	9.6	-7.0	403	14	0.4	1.9	0.30	0.51	0.73	1.09	55.8	11.1	
COLLINS & AIKMAN CKC		937.2	8	90	NM	-32.0	857	NM	0.5	NM	0.00	-0.03	-0.19	0.04	200.0	7.0	
INTERFACE IFSIA		252.1	5	-43	-14.0	-8.2	78	NM	0.2	2.8	1.21	0.34	0.14	0.25	4.0	12.5	
MOHAWK INDUSTRIES MHK		2410.5	46	68	33.2	19.1	273	14	0.7	1.0	0.00	3.00	3.22	3.58	3.4	15.0	
WESTPOINT STEVENS WXS		112.1	2	-70	NM	NM	NM	NM	0.1	NM	0.00	-1.28	-0.24	0.50	16.0	10.0	
16 METALS & MINING																	
INDUSTRY AVERAGE		3275.8	20	17	-9.7	8.1	160	46	0.6	4.5	1.53	0.55	-0.33	0.67	122.9	12.0	
(A) ALUMINUM																	
GROUP AVERAGE		16468.2	20	-17	25.4	35.4	185	12	0.7	1.6	0.78	1.01	0.32	0.86	78.9	12.5	
ALCOA AA		32783.1	39	15	25.4	13.3	305	23	1.4	1.6	1.55	1.81	1.63	2.01	16.4	15.0	
KAISER ALUMINUM KLU		153.3	2	-48	NM	57.4	65	1	0.1	NM	0.00	0.21	-0.99	-0.29	141.4	10.0	
(B) STEEL																	
GROUP AVERAGE		1173.1	21	19	-6.0	0.3	99	55	0.4	1.9	1.98	0.56	-0.85	0.79	190.4	10.4	
AK STEEL HOLDING AKS		1141.9	11	21	14.0	-0.1	92	NM	0.3	NM	0.00	1.20	0.35	0.20	165.0	5.0	
CARPENTER TECHNOLOGY CRS (6)		570.2	26	27	-17.7	3.7	90	24	0.5	1.2	5.13	2.31	1.50*	1.29	24.8	14.0	
NATIONAL STEEL NS		48.7	1	-1	NM	NM	14	NM	0.0	NM	0.00	-3.14	9.46	-2.30	NA	10.0	
NUCOR NUE		3848.8	49	25	7.7	7.6	176	23	0.9	3.2	1.37	3.80	1.31	2.02	25.7	12.0	
RYERSON TULL RT		277.6	11	36	NM	5.3	43	NM	0.1	NM	1.79	1.03	0.55	0.24	370.8	NA	
TEXAS INDUSTRIES TXI (5)		726.9	35	16	22.4	0.8	101	139	0.6	1.1	0.86	1.24	2.35	3.90	5.4	13.5	
USX-U.S. STEEL GROUP X		1506.5	17	6	NM	10.4	82	NM	0.2	NM	2.37	-0.33	-2.26	-0.10	730.0	8.0	
WORTHINGTON INDUSTRIES WOR (5)		1263.8	15	84	-11.7	5.8	195	34	0.7	2.2	4.32	0.42	0.67	1.03	10.7	10.2	

STMENT OUTLOOK SCOREBOARD

EARNINGS PER SHARE

													2002 ESTIMATES FROM ANALYSTS				
IPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING	
OTHER METALS																	
GROUP AVERAGE	1909.6	18	25	-23.1	8.1	233	53	0.8	7.3	1.22	0.40	0.08	0.48	58.8	13.6		
ELHARD EC	3635.1	28	37	6.1	16.3	360	23	0.6	1.6	1.43	1.31	1.71	1.82	3.3	10.5	B+	
PORT-McMORAN COPPER & GOLD FCX	1922.0	13	56	-26.7	23.9	NM	14	1.0	1.2	0.00	0.26	0.55	0.68	25.0	20.0	B-	
ERAL CABLE BGC	393.9	12	170	NM	43.9	381	9	0.2	0.7	1.67	-0.79	1.05	1.38	23.2	17.5	NR	
DMONT MINING NEM	3856.0	20	15	NM	-2.2	266	NM	2.3	32.8	0.61	-0.06	0.03	0.35	71.4	20.0	B-	
COLN	717.0	17	-25	-19.6	1.7	265	165	0.5	NM	4.84	1.80	-0.10	0.48	154.2	6.5	B	
LPS DODGE PO	2819.8	36	36	52.1	-6.8	102	NM	0.7	NM	0.00	0.37	-4.03	-2.04	75.5	8.0	B-	
ERIDR TELECOM SUT	23.4	1	-44	NM	20.0	24	NM	0.0	0.1	0.00	-0.11	1.33	0.70	NA	12.5	NR	
NONBANK FINANCIAL																	
GROUP AVERAGE	17827.7	951	-7	13.3	10.7	248	24	1.5	1.9	1.20	31.15	12.45	25.15	6.3	13.1		
FINANCIAL SERVICES																	
GROUP AVERAGE	26047.9	2162	-8	20.4	15.9	363	25	1.9	1.6	0.80	68.48	26.36	54.40	7.4	15.3		
ANCEPCS ADVP (3)	2533.0	28	22	38.8	8.1	320	40	0.2	0.9	0.00	0.31	1.22	1.52	0.7	26.0	NR	
ERICAN EXPRESS AXP	43967.8	33	-40	12.2	13.8	360	26	1.7	2.2	0.97	2.07	1.17	1.95	5.1	13.0	A-	
R STEARNS BSC (11)	5412.5	58	13	16.1	12.2	124	13	0.6	1.2	1.04	5.35	4.14	4.53	7.3	12.0	A	
KSHIRE HATHAWAY BRK.A	106960.0	70000	1	1.4	3.1	187	60	2.6	6.4	0.00	2185.00	788.50	1704.00	28.7	13.8	B	
CK (H&R) HR8 (4)	7309.4	40	93	20.7	35.0	800	23	2.4	1.2	1.61	1.50	2.18	2.40	2.5	15.0	A-	
ITAL DNE FINANCIAL COF	10553.9	50	-24	32.3	19.9	354	18	1.5	0.7	0.21	2.24	2.91	3.52	1.7	24.0	NR	
GROUP C	246408.3	48	6	15.7	16.8	322	19	2.2	1.1	1.34	2.62	2.84	3.30	3.3	15.0	A	
ICORD EFS CEFT	15092.0	30	36	42.7	10.8	874	80	9.5	1.7	0.00	0.42	0.59	0.76	1.3	30.0	B+	
INTRYWIDE CREDIT INDS. CCR (2)	5187.8	42	-15	6.9	12.1	133	11	0.9	0.7	0.94	3.14	4.53	4.58	4.2	13.0	A	
I & BRADSTREET DNB	2691.1	34	32	NM	NM	NM	25	2.0	2.0	0.00	0.90	1.72	1.91	3.7	10.0	NR	
RADE GROUP ET	2636.4	8	8	4.7	-15.5	176	NM	1.3	4.8	0.00	0.06	0.08	0.34	17.7	21.0	C	
VARDS (A.G.) AGE (2)	3370.1	43	-10	11.2	11.5	204	18	1.3	1.4	1.50	3.43	2.03	2.31	11.7	15.0	A	
IFAX EFV	3414.8	25	-13	12.8	67.0	1295	19	2.5	1.8	0.32	1.68	1.14	1.27	3.2	12.0	A	
NIE MAE FNM	78678.6	79	-9	14.1	36.8	686	16	1.6	1.1	1.53	4.26	5.18	5.99	0.8	14.0	A+	
ELITY NATIONAL FINANCIAL FNF	1964.9	23	-32	6.5	16.2	124	8	0.6	0.6	1.76	1.62	3.36	3.20	6.3	11.5	B+	
ST AMERICAN FAF	1219.2	18	-46	7.1	13.8	115	9	0.4	0.6	1.57	1.24	2.23	1.78	2.8	12.5	B	
INKLIN RESOURCES BEN (9)	9323.5	36	-6	2.8	12.2	234	19	4.0	1.3	0.73	2.28	1.91*	1.84	4.9	14.0	A	
DDIE MAC FRE	45916.8	66	-4	19.5	23.0	474	14	1.4	1.1	1.21	3.39	4.19	4.85	1.0	14.0	A+	
DMAN SACHS GROUP GS (11)	42707.9	89	-17	NA	13.4	238	20	1.3	1.6	0.54	6.00	4.20	4.80	8.3	13.0	NR	
JSEHOLD INTERNATIONAL HI	27061.8	59	7	19.5	22.2	342	15	2.0	1.0	1.49	3.55	4.08	4.63	1.3	14.4	A	
TINET GROUP INET	2132.5	9	NA	NA	9.9	156	14	1.4	NA	0.00	0.72	0.63	0.77	5.2	NA	NR	
GHT TRADING GROUP NITE	1444.8	12	-16	49.0	7.3	176	25	1.9	1.8	0.00	2.05	0.35	0.57	40.4	19.0	NR	
IGAMERICA FINANCIAL GROUP LFG	455.2	25	-39	NM	-7.1	62	NM	0.2	0.5	0.82	-6.60	3.90	3.30	12.4	12.0	NR	
IG MASON LM (3)	3148.7	47	-13	24.8	14.4	313	22	2.1	1.9	0.85	2.30	2.07	2.75	7.6	12.3	A	
IMAN BROTHERS HOLDINGS LEH (11)	15813.0	66	-2	43.2	17.6	213	12	0.7	1.2	0.42	6.38	4.72	5.35	6.4	12.0	NR	
RSB & McLENNAN MMC	29337.5	107	-9	19.8	21.9	576	28	3.0	1.8	1.98	4.10	4.19	4.80	2.3	14.0	A	
RRILL LYNCH MER	42339.1	50	-27	19.6	12.7	205	18	1.0	1.6	1.28	4.11	2.42	2.99	9.4	13.0	A	
TRIS MXT	1329.6	21	-21	46.1	18.9	191	9	0.8	0.4	0.19	2.15	2.59	2.96	6.8	20.0	NR	
RGAN STANLEY DEAN WITTER MWO (11)	61400.6	56	-30	31.2	19.6	312	16	1.3	1.4	1.66	4.73	3.06	3.51	10.5	13.0	NR	
(MMD) JAMES FINANCIAL RJF (9)	1545.4	32	-7	-0.9	12.5	200	16	0.9	NA	1.11	2.67	1.98*	2.19	0.5	NA	A-	
HWAB (CHARLES) SCH	19649.6	14	-49	24.6	5.5	470	84	3.4	2.5	0.31	0.51	0.29	0.45	15.6	20.0	A+	
LWELL FINANCIAL SV	5239.7	24	-40	49.3	30.1	414	14	3.0	1.0	0.17	2.90	1.69	1.61	9.3	13.5	NR	
A EDUCATION SLM	13336.4	85	25	0.5a	13.5	980	74	3.1	1.7	0.94	2.76	3.73	4.44	1.8	13.5	A	
INSURANCE																	
GROUP AVERAGE	12642.9	45	-8	4.6	5.2	162	25	1.2	2.5	1.39	2.61	1.82	3.23	6.3	11.5		
AC AFL	14340.3	27	-24	16.5	12.4	258	21	1.5	1.4	0.73	1.26	1.34	1.54	0.7	15.0	A+	
AMERICA FINANCIAL AFC	2268.9	43	-41	2.0a	5.2	90	18	0.7	1.3	0.58	3.70	3.12	3.88	12.6	10.8	NR	
STATE ALL	24413.1	34	-21	6.3	8.4	141	17	0.9	1.5	2.22	2.95	2.24	2.68	8.6	10.0	NR	
ERICAN FINANCIAL GROUP AFG	1676.7	25	-7	NM	-7.7	106	NM	0.4	1.6	4.07	-0.80	1.27	2.23	13.0	12.0	B	
ERICAN INTERNATIONAL GROUP AIG	215268.3	82	-16	15.0	10.1	424	41	3.9	2.0	0.20	2.41	2.81	3.46	3.5	15.0	A+	
N AOC	9646.1	36	5	13.5	5.6	266	47	1.3	2.0	2.51	1.82	1.53	2.35	6.4	11.5	B+	
RKLEY (W.R.) BER	1555.3	54	13	-13.9	-1.1	192	NM	0.8	5.9	0.97	1.39	0.76	3.98	2.3	12.0	B	
UBB CB	11868.2	70	-19	10.1	3.8	179	52	1.6	4.0	1.94	4.01	1.45	4.70	2.8	12.0	B+	
NA CI	13194.3	91	-31	14.9	20.2	248	13	0.7	0.9	1.40	6.08	6.96	7.69	1.6	14.5	B+	
MCINNATI FINANCIAL CINF	6232.8	39	-2	-13.8	2.0	105	55	2.5	3.0	2.18	0.73	1.30	1.70	2.4	10.0	A-	
IA FINANCIAL CNA	6260.7	28	-28	6.3	-15.9	73	NM	0.5	NM	0.00	6.61	10.90	2.73	25.6	8.0	B-	
NSECD CNC	1444.1	4	-68	NM	-14.9	32	NM	0.2	0.6	0.00	-3.51	0.70	0.90	24.4	11.0	B	
EREST RE GROUP RE	3301.0	71	0	16.3	6.7	192	29	1.9	1.9	0.39	4.02	2.74	5.54	0.9	14.0	B	
ARTFORD FINANCIAL SERVICES HIG	14094.8	59	-16	NM	7.6	161	21	0.9	1.7	1.76	4.34	2.98	4.80	5.0	12.0	NR	
FFERSON-PILOT JP	6695.1	45	-11	16.2	15.4	195	13	2.0	1.4	2.47	3.29	3.04	3.34	1.2	10.2	A+	
HN HANCOCK FINANCIAL SERVICES JHF	11790.2	39	5	NA	12.2	193	16	1.6	1.3	0.79	2.65	2.60	2.84	1.4	12.0	NR	
NCNLDN NATIONAL LNC	9035.2	48	1	17.2	10.9	168	16	1.4	1.2	2.68	3.19	3.40	3.80	5.3	11.8	A-	
LEWS LTR	10882.6	57	10	12.2	-2.3	112	NM	0.6	1.0	1.06	9.44	5.13	7.37	16.7	11.0	B	
MERCURY GENERAL MCY	2372.1	44	0	1.2	10.1	220	22	1.6	1.8	2.42	2.02	2.03	2.50	4.0	12.0	A-	
ETLIFE MET	19910.2	27	22	NA	7.0	118	18	0.6	1.2	0.73	1.21	1.91	2.47	2.0	12.0	NR	
ONY GROUP MNY	1501.6	31	37	NA	1.7	69	44	0.8	7.9	1.44	5.49	0.61	1.19	10.1	6.5	NR	

EARNINGS PER SHARE

2002 ESTIMATES FROM ANALYSTS

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	E RATIO
NATIONWIDE FINANCIAL SERVICES	NFS	4958.8	39	-19	16.5a	13.5	142	11	1.5	0.8	1.25	3.38	3.38	3.43	1.8	14.0	
OHIO CASUALTY	Ocas	895.2	15	49	NM	4.3	83	20	0.5	NM	0.00	-1.32	-0.17	1.10	9.1	10.0	
OLO REPUBLIC INTERNATIONAL	ORI	3193.4	27	-16	9.1	13.1	119	9	1.4	1.0	2.23	2.47	2.76	2.94	2.4	10.0	
PHOENIX	PNX	1665.3	16	NA	NA	-9.2	70	NM	0.7	NM	0.00	0.90	-0.89	0.67	11.9	10.0	
PRINCIPAL FINANCIAL GROUP	PFG	8613.5	23	NA	NA	9.3	132	NA	1.0	1.0	0.00	NA	1.92	2.09	1.9	11.8	
PROGRESSIVE	PGR	10740.7	147	41	-38.1	10.8	346	33	1.5	1.7	0.19	0.62	6.35	7.41	6.2	14.0	
PROTECTIVE LIFE	PL	1926.4	28	-13	12.2	10.4	131	13	1.0	1.0	1.99	2.32	2.42	2.51	2.0	12.0	
REINSURANCE GROUP OF AMERICA	RGA	1706.9	35	-3	8.8	9.8	186	19	0.9	1.1	0.70	2.12	2.46	3.17	2.8	12.8	
SAFECO	SAFC	4110.1	32	-2	-28.7	-27.7	109	NM	0.6	17.9	2.30	0.90	0.20	1.78	7.9	9.0	
ST. PAUL	SPC	9745.6	47	-13	0.3a	-1.6	164	NM	1.1	NM	2.38	4.32	-0.69	3.31	4.8	10.0	
STANCORP FINANCIAL GROUP	SFG	1373.5	46	-4	NA	9.7	139	15	0.8	1.1	0.70	2.95	3.40	3.88	1.6	12.1	
TORCHMARK	TMK	4898.7	39	3	12.3	15.7	193	13	1.8	1.3	0.91	2.82	3.12	3.44	1.5	10.0	
TRANSATLANTIC HOLDINGS	TRH	4701.8	90	28	7.9	3.4	253	75	2.3	7.7	0.43	4.03	1.17	4.56	3.1	10.0	
UNITRIN	UTR	2618.0	39	-4	-6.9	20.1	125	6	1.4	NA	4.11	1.32	0.75	1.61	17.4	NA	
UNUMPROVIOENT	UNM	6245.0	26	-4	7.5	10.0	104	10	0.7	0.9	2.29	2.33	2.38	2.66	2.3	12.0	

(C) SAVINGS & LOAN

GROUP AVERAGE	7250.5	30	-3	16.1	14.3	171	17	1.6	1.0	2.00	1.97	2.88	3.19	2.1	11.5
ASTORIA FINANCIAL ASFC	2290.1	25	-9	31.0	13.9	148	11	1.5	2.1	2.74	2.16	1.19	1.47	1.4	10.0
CHARTER ONE FINANCIAL CF	6183.0	28	0	18.8	16.2	211	13	2.2	1.0	2.90	1.90	2.32	2.65	1.6	12.0
DIME BANCORP DME	4080.4	35	17	8.6	17.4	204	12	1.7	1.1	1.39	1.35	2.93	3.12	2.6	11.0
GOLDEN STATE BANCORP GS8	3376.1	25	-21	-28.3	16.1	139	9	0.8	0.9	1.61	2.44	2.82	3.41	4.4	10.0
GOLOEN WEST FINANCIAL GDW	8197.1	52	-23	13.0	17.6	194	11	1.8	0.8	0.56	3.41	4.99	5.13	2.7	13.0
GREENPOINT FINANCIAL GPT	3621.0	36	-12	10.3	12.6	157	11	2.1	0.7	2.79	2.34	4.08	4.54	2.0	13.0
SOVEREIGN BANCORP SOV	2735.5	11	36	NM	2.2	127	58	1.0	1.0	0.90	-0.18	1.10	1.25	0.0	10.0
WASHINGTON MUTUAL WM	27521.1	31	-12	59.4	18.5	189	10	1.5	0.7	3.07	2.36	3.57	3.94	2.0	13.0

18 OFFICE EQUIPMENT & COMPUTERS

INDUSTRY AVERAGE	27031.1	31	9	11.9	2.4	523	53	3.3	2.9	0.28	0.69	0.78	1.10	76.5	18.1	
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(A) BUSINESS MACHINES & SERVICES

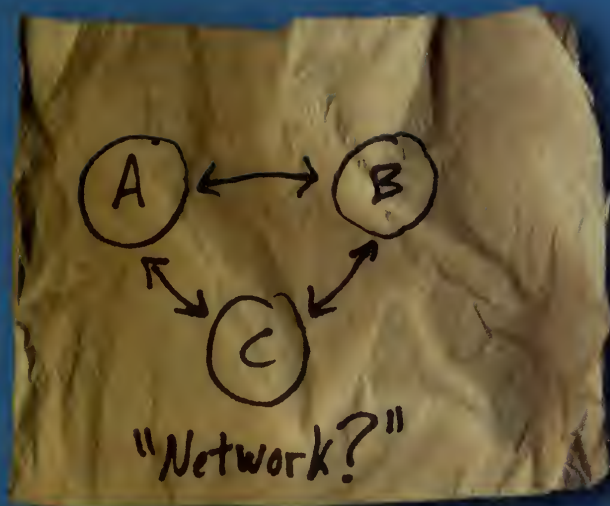
GROUP AVERAGE	3061.6	29	16	15.5	16.4	304	19	0.9	2.1	1.26	1.76	1.27	1.53	24.6	14.1
COMPUCOM SYSTEMS CMPC	98.8	2	60	-39.2	5.1	45	9	0.1	2.1	0.00	0.09	0.10	0.03	133.3	10.0
DIEBOLO DBD	2770.5	39	16	7.8	9.6	315	33	1.6	1.4	1.65	1.92	1.95	2.20	5.0	14.5
HON INDUSTRIES HNI	1501.1	26	0	11.9	13.1	261	20	0.8	1.1	1.88	1.77	1.51	1.60	8.8	15.0
MILLER (HERMAN) MLHR (5)	1650.4	22	-24	24.2	31.3	490	16	0.8	4.3	0.66	1.86	0.34	1.03	18.5	15.0
NCR NCR	3739.2	38	-22	NM	12.3	192	16	0.6	1.8	0.00	1.82	1.41	1.84	4.9	15.0
PITNEY BOWES PBI	10114.9	41	25	15.4	43.6	800	19	2.5	1.7	2.80	2.18	2.25	2.37	0.8	11.0
STEELCASE SCS (2)	2094.5	14	2	63.9	6.7	129	20	0.6	3.4	3.09	1.29	0.35	0.54	22.2	12.0
TECH DATA TECD (1)	2523.3	46	69	24.5	10.0	199	20	0.1	1.0	0.00	3.14	2.27	2.65	3.4	20.0

(B) COMPUTERS & PERIPHERALS

GROUP AVERAGE	25245.7	21	2	15.8	-7.4	566	96	1.4	5.6	0.17	0.40	0.25	0.62	54.7	15.3	
APPLE COMPUTER AAPL (9)	7474.6	21	43	NM	-0.9	191	NM	1.4	NM	0.00	2.18	-0.11*	0.47	21.3	10.0	
COMPAQ COMPUTER CPQ	17194.1	10	-33	-21.0	-12.2	153	NM	0.5	13.0	0.99	0.34	0.06	0.16	93.8	13.0	
DELL COMPUTER DELL (1)	72869.4	28	60	46.3	25.6	1524	62	2.3	2.9	0.00	0.81	0.65	0.74	6.8	15.0	
EMC EMC	37199.3	17	-75	39.0	1.6	485	336	4.5	22.4	0.00	0.79	0.03	-0.07	85.7	25.0	
GATEWAY GTW	3045.2	9	-48	-0.9	-85.6	227	NM	0.4	NM	0.00	0.76	-0.21	0.16	93.8	13.5	
HEWLETT-PACKARD HWP (10)	42638.6	22	-30	15.3b	4.5	306	69	0.9	5.7	1.46	1.73	0.32*	0.88	15.9	12.0	
INTERNATIONAL BUSINESS MACHINES IBM	199120.2	116	36	15.7	36.6	906	26	2.3	2.2	0.48	4.44	4.37	4.81	2.7	12.0	
LEXMARK INTERNATIONAL LXK	6703.9	52	17	25.7	27.1	622	24	1.6	1.7	0.00	2.13	2.21	2.34	6.4	14.0	
MAXTOR MXO	1422.9	6	5	NM	-44.5	132	NM	0.4	NM	0.00	0.27	-0.92	-0.29	72.4	25.0	
PALM PALM (5)	1979.7	3	-88	NM	-57.8	282	NM	1.4	NM	0.00	-0.63	-0.23	-0.06	250.0	25.0	
QUANTUM QLT & STORAGE SYSTEMS DSS (3)	1476.8	10	-28	NA	3.3	253	86	1.2	4.5	0.00	1.08	0.21	0.31	74.2	10.0	
SILICON GRAPHICS SGI (6)	415.5	2	-47	NM	NM	NM	NM	0.2	NM	0.00	-4.52	-2.59*	-0.54	14.8	10.0	
STORAGE TECHNOLOGY STK	2222.1	21	137	NM	5.9	227	38	1.1	3.1	0.00	-0.02	0.56	0.77	10.4	12.5	
SUN MICROSYSTEMS SUNW (6)	46160.4	14	-49	6.3a	2.8	450	203	2.9	2.5	0.00	0.55	0.29*	-0.06	83.3	20.0	
SYMBOL TECHNOLOGIES SBL	3795.8	17	-31	NM	-21.1	327	NM	2.5	2.5	0.12	-0.33	0.27	0.48	43.8	25.0	
UNISYS UIS	3797.4	12	-19	NM	7.0	168	24	0.6	1.6	0.00	0.77	0.51	0.83	21.7	15.0	
WESTERN DIGITAL WDC (6)	879.9	5	93	NM	NM	3182	NM	0.5	NM	0.00	-2.69	-0.52*	0.00	NM	10.0	
XEROX XRX	6027.2	8	82	NM	-10.5	196	NM	0.4	NM	0.00	-0.44	-0.41	0.24	33.3	9.0	

(C) COMPUTER SOFTWARE & SERVICES

GROUP AVERAGE	35027.2	37	13	8.8	4.1	559	47	5.2	1.9	0.08	0.58	0.97	1.28	104.5	21.1
AOOBE SYSTEMS AD8E (11)	7609.1	32	-45	22.9	37.4	1136	32	5.8	1.4	0.16	1.13	1.16	1.04	8.7	20.0
AFFILIATED COMPUTER SERVICES ACS (6)	4723.4	93	54	25.6	15.7	501	35	2.1	1.9	0.00	2.07	2.46*	3.51	0.3	20.0
AMERICAN MANAGEMENT SYSTEMS AMSY	637.8	15	-23	29.2	7.7	171	23	0.5	0.7	0.00	1.05	1.16	1.25	15.2	20.0
AOL TIME WARNER AOL (6)	154683.8	35	0	NM	NA	100	NA	NA	1.2	0.00	0.48	1.18	1.32	4.6	24.0
AUTOMATIC OATA PROCESSING ADP (6)	34196.6	55	12	13.7	20.7	748	37	4.9	2.6	0.83	1.31	1.44*	1.75	1.1	15.0
BMC SOFTWARE BMC (3)	4090.7	17	20	32.3	-2.6	245	NM	2.8	3.1	0.00	0.17	0.27	0.54	25.9	20.0
CAQENCE OESIGN SYSTEMS CDN	5831.6	24	-13	-37.5a	15.0	605	43	4.0	1.6	0.00	0.19	0.82	1.10	4.6	18.0
CISCO SYSTEMS CSCO (7)	149702.6	20	47	NM	-7.6	545	NM	7.4	NM	0.00	0.36	-0.14*	0.22	18.2	25.0
COMPUTER ASSOCIATES INTL. CA (3)	19163.1	33	71	NM	-26.9	371	NM	6.5	0.9	0.24	-1.02	2.39	2.51	7.6	15.0



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EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2002 ESTIMATES FROM ANALYSTS				
											2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %
COMPUTER SCIENCES CSC (3)	8106.7	48	-21	2.5	4.2	239	57	0.7	1.7	0.00	1.37	1.87	2.43	8.6	15.0
COMPUWARE CPWR (3)	4152.3	11	79	3.3	9.9	286	29	2.2	1.6	0.00	0.32	0.47	0.58	10.4	15.0
DST SYSTEMS DST	5739.7	48	-29	5.1	18.9	443	25	3.6	1.5	0.00	1.67	1.60	1.87	3.2	20.0
EBAY EBAY	18719.3	68	106	-1.3	6.7	1428	206	28.2	2.9	0.00	0.17	0.47	0.74	5.4	50.0
ELECTRONIC ARTS ERTS (3)	8646.2	60	42	NA	-0.8	851	NM	6.3	3.6	0.00	-0.08	0.67	1.43	10.5	25.0
ELECTRONIC DATA SYSTEMS EDS	32802.9	69	20	28.8	22.4	564	25	1.6	1.7	0.87	2.40	2.66	3.06	2.9	15.0
FIRST DATA FDC	27904.4	73	39	12.6	24.2	818	36	4.5	2.0	0.11	2.25	2.50	2.89	3.8	15.0
FISERV FISV	7310.6	39	24	20.2	14.1	516	37	4.0	1.9	0.00	0.93	1.07	1.27	0.8	19.0
INGRAM MICRO IM	2281.5	15	37	11.7	3.3	123	37	0.1	3.3	0.00	1.51	0.31	0.54	20.4	15.0
INTUIT INTU (7)	9181.4	44	11	NM	-6.9	447	NM	7.2	NM	0.00	1.45	-0.47*	1.00	2.0	24.5
MICROSOFT MSFT (6)	345819.3	64	48	19.1	13.2	713	56	13.5	3.1	0.00	1.70	1.38*	1.83	2.7	15.0
ORACLE ORCL (5)	77991.6	14	-52	13.2	41.3	1254	31	7.2	1.6	0.00	0.44	0.45	0.52	5.8	20.0
PEOPLESFT PSFT	10573.4	35	-6	27.0	12.5	740	62	5.2	2.5	0.00	0.48	0.57	0.72	6.9	25.0
PRICELINE.COM PCLN	939.1	4	220	NA	-71.3	658	NM	0.8	NA	0.00	-1.97	0.05	0.11	18.2	NA
SABRE HOLOINGS TSG	4648.3	35	-20	-6.1	-0.6	426	NM	2.0	1.2	0.00	1.11	1.71	1.38	18.1	17.5
SIEBEL SYSTEMS SEBL	10325.1	22	-67	NA	15.9	611	43	4.8	1.6	0.00	0.24	0.46	0.47	6.4	30.0
SUNGARO DATA SYSTEMS SDS	7841.1	28	19	NA	14.3	461	33	4.3	1.6	0.00	0.79	0.88	1.08	3.7	20.0
3COM COMS (5)	1551.0	4	-47	NM	-50.0	68	NM	0.7	NM	0.00	-2.81	-0.83	0.01	2700.0	15.0
VERITAS SOFTWARE VRTS	15590.1	39	-56	NM	-21.1	576	NM	10.5	1.7	0.00	-1.55	0.65	0.64	9.4	36.0

19 PAPER & FOREST PRODUCTS

INDUSTRY AVERAGE	7646.0	38	-1	5.3	4.0	179	55	0.8	11.9	1.85	2.22	1.00	1.32	94.0	8.6
(A) FOREST PRODUCTS															
GROUP AVERAGE	2442.3	26	7	10.5	-0.2	130	16	0.5	7.3	1.30	1.53	0.64	1.12	23.5	9.9
GEORGIA-PACIFIC GROUP GP	7370.1	32	3	NM	-9.2	142	NM	0.3	19.0	1.56	1.94	0.26	1.22	50.8	6.5
LOUISIANA-PACIFIC LPX	802.2	8	-24	NM	-13.0	68	NM	0.3	NM	0.00	-0.13	-0.32	-0.74	32.4	7.0
RAYONIER RYN	1246.7	46	15	NM	8.9	177	20	1.0	2.1	3.15	2.82	2.00	2.17	7.4	11.0
UNIVERSAL FOREST PRODUCTS UFPI	350.2	18	34	10.5	12.3	133	11	0.2	0.7	0.51	1.49	1.61	1.82	3.3	15.0

(B) PAPER

GROUP AVERAGE	10619.6	44	-5	4.4	6.5	206	69	1.0	14.2	2.16	2.62	1.20	1.43	134.3	7.8
BOISE CASCADE BCC	1859.2	32	-5	NM	0.6	114	229	0.3	9.0	1.87	2.73	0.51	0.78	89.7	7.0
BOWATER BOW	2627.8	48	-15	-11.9	5.5	129	22	1.1	50.1	1.66	3.02	0.12	0.12	675.0	8.0
INTERNATIONAL PAPER IP	19251.9	40	-2	-3.6	-8.2	178	NM	0.7	17.3	2.50	0.82	0.33	0.97	45.4	7.0
KIMBERLY-CLARK KMB	30609.1	58	-18	16.1	26.7	516	18	2.1	1.7	1.93	3.31	3.24	3.46	2.0	10.5
MEAO MEA	3069.7	31	-1	-2.1	1.3	129	103	0.7	NM	2.20	1.60	-0.05	0.37	70.3	8.0
WEYERHAEUSER WY	11618.1	53	4	12.3	8.2	169	21	0.8	3.8	3.03	3.72	1.97	2.11	35.6	7.0
WILLAMETTE INDUSTRIES WLL	5301.4	48	3	15.9	11.5	210	18	1.2	3.0	1.91	3.12	2.28	2.20	21.8	7.0

20 PUBLISHING & BROADCASTING

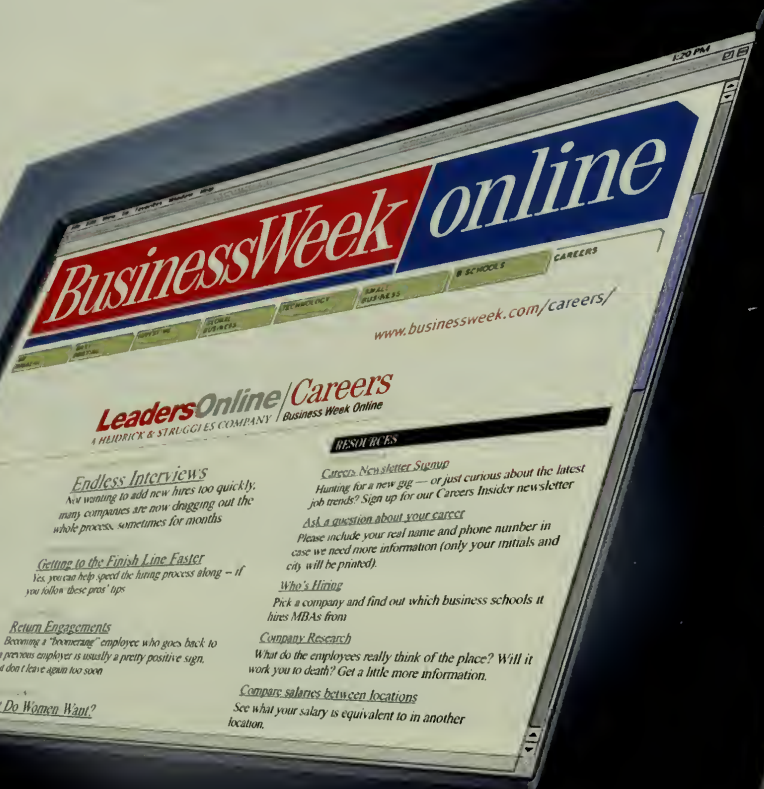
INDUSTRY AVERAGE	13703.3	53	-15	26.0	3.9	741	86	2.1	5.5	0.79	0.59	-0.48	0.09	30.0	15.1
(A) BROADCASTING															
GROUP AVERAGE	22457.9	29	-18	8.8	-4.6	168	166	2.6	17.0	0.09	-1.29	-2.97	-2.33	37.0	18.6
AOELPHIA COMMUNICATIONS ADLAC	4347.4	25	-51	NM	-12.9	93	NM	1.3	NM	0.00	-4.45	-3.23	-4.26	15.0	14.0
CABLEVISION SYSTEMS CVC	11292.3	42	-51	NM	NM	NM	5	2.6	NM	0.00	1.29	-4.99	-4.11	13.9	12.3
CHARTER COMMUNICATIONS CHTR	4528.3	15	-32	NA	-33.9	143	NM	1.2	NM	0.00	-3.67	-4.33	-3.85	30.7	14.2
CLEAR CHANNEL COMMUNICATIONS CCU	27927.7	47	-4	22.7	-3.2	93	NM	3.4	NM	0.00	0.57	-1.79	-1.37	27.7	29.0
COMCAST CMCSK	35907.3	38	-9	NM	9.0	242	28	3.9	NM	0.00	2.16	-1.25	-1.03	29.1	14.0
COX COMMUNICATIONS COX	23387.5	39	-16	NM	0.7	234	354	6.0	NM	0.00	3.16	-0.73	-0.62	32.3	14.5
OISNEY (WALT) DIS (9)	42260.3	20	-29	-50.1	0.5	180	341	1.7	28.4	1.03	0.43	0.06*	0.62	11.3	12.0
ECHOSTAR COMMUNICATIONS DISH	12684.1	26	16	NM	NM	NM	NM	3.5	NM	0.00	-1.32	-0.40	0.58	37.9	37.5
FOX ENTERTAINMENT GROUP FOX (6)	21597.7	26	43	53.8	1.5	190	102	2.5	5.5	0.00	0.20	0.28*	0.27	29.6	16.5
UNITEDGLOBALCOM UCOMA	139.3	1	-90	NM	NM	NM	NM	0.1	NM	0.00	-13.24	-18.80	-13.79	54.4	NA
USA NETWORKS USAI	8486.0	23	16	NM	-3.3	212	NM	1.6	NM	0.00	-0.25	-0.39	-0.45	84.4	20.0
VIACOM VIA.B	76937.5	44	-7	NM	-0.2	122	NM	3.3	NM	0.00	-0.30	-0.05	0.09	77.8	20.0

(B) PUBLISHING

GROUP AVERAGE	5622.1	76	-12	30.7	10.8	1139	42	1.7	3.4	1.44	2.32	1.81	2.32	23.6	12.2
BELO BLC	1966.9	18	12	4.8	6.5	149	23	1.4	9.3	1.68	1.29	0.16	0.43	55.8	12.0
DOV JONES DJ	4299.0	51	-11	NM	NM	8965	NM	2.3	3.8	1.98	-1.35	1.20	1.62	11.7	11.0
GANNETT GCI	18394.0	69	10	14.6	15.9	334	21	2.8	2.1	1.32	3.63	3.14	3.43	4.7	10.5
HOLLINGER INTERNATIONAL HLR	1096.3	11	-32	28.2	-14.5	243	NM	0.8	NM	5.07	1.11	-0.20	-0.20	135.0	15.0
KNIGHT-RIDDER KRI	4510.9	61	7	20.1	5.4	299	62	1.5	2.2	1.65	3.53	2.82	3.17	5.4	10.0
MCGRAW-HILL MHP	10921.5	57	4	-0.5	24.8	558	23	2.4	2.0	1.73	2.41	1.1	1.1	1.1	1.1
NEW YORK TIMES NYT	6945.4	45	13	53.2	22.9	597	28	2.2	2.5	1.10	2.32	1.69	1.97	8.6	11.0
PRIMEIRA PRM	523.3	2	-82	NM	NM	1921	NM	0.3	NM	0.00	-2.48	2.08	1.20	40.0	15.0
READER'S DIGEST ASSOCIATION RDA (6)	2250.5	23	-42	0.6	25.9	527	22	0.9	1.6	0.89	1.34	1.26*	1.10	8.2	11.0
SCHOLASTIC SCHL (5)	1533.2	43	-2	220.1	3.3	333	152	0.8	1.2	0.00	1.01	2.42	2.95	7.1	15.0
SCRIPPS (E.W.) SSP	5052.1	64	2	2.2a	13.3	379	29	3.3	2.9	0.94	2.06	1.78	2.12	6.6	12.5
TRIBUNE TRB	10754.0	36	-15	2.5	0.3	205	NM	2.0	4.1	1.22	0.99	0.71	0.90	11.1	12.5
WASHINGTON POST WPO	4840.4	510	-17	-8.1	15.1	293	19	2.0	5.6	1.10	14.32	8.24	11.16	10.4	11.0

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EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST	2002 ESTIMATES FROM ANALYST			LONG-TERM GROWTH RATE %
													CONSENSUS	VARIATION %		
21 SERVICE INDUSTRIES																
INDUSTRY AVERAGE	2735.4	23	25	17.1	6.5	280	26	0.8	1.7	0.76	1.22	1.06	1.31	13.3	15.5	
(A) CONSTRUCTION & ENGINEERING																
GROUP AVERAGE	858.9	23	0	19.2	6.0	149	13	0.3	1.0	0.60	1.49	1.54	1.72	13.7	13.9	
EMCOR GROUP EME	621.6	45	78	40.0	11.7	154	14	0.2	1.0	0.00	2.95	3.36	3.71	1.4	13.0	
ENCOMPASS SERVICES ESR	92.9	1	-71	32.0	1.2	13	8	0.0	NM	0.00	0.77	-0.06	0.28	46.4	15.0	
FLUOR FLR (10)	3031.7	38	14	NA	14.8	397	NA	NA	1.9	1.69	1.31	1.80	2.12	2.8	11.0	
FOSTER WHEELER FWC	215.3	5	1	-16.9	6.1	59	10	0.1	0.9	3.03	0.97	0.57	0.81	7.4	10.0	
GRANITE CONSTRUCTION GVA	1003.1	24	26	19.5	12.6	246	19	0.7	1.6	1.31	1.38	1.23	1.71	5.9	12.5	
INTEGRATED ELECTRICAL SERVICES IEE (9)	162.1	4	-31	-7.5	5.7	32	6	0.1	0.4	0.00	0.52	0.70*	0.59	27.1	13.5	
JACOBS ENGINEERING GROUP JEC (9)	1846.0	69	49	16.0	14.8	312	21	0.5	1.4	0.00	1.93	3.22*	3.76	2.7	15.0	
MASTEC MTZ	260.8	5	-73	14.7	-15.8	62	NM	0.2	0.4	0.00	1.35	0.92	0.60	21.7	14.0	
QUANTA SERVICES PWR	935.9	16	-52	46.2	7.2	79	14	0.5	0.8	0.00	1.42	1.23	1.08	18.5	15.0	
URS URS (10)	419.6	24	61	29.0	10.9	141	10	0.2	0.5	0.00	2.27	2.38	2.53	2.8	20.0	
(B) INDUSTRIAL DISTRIBUTION																
GROUP AVERAGE	1580.0	22	13	4.4	2.1	174	31	0.4	1.7	0.72	1.41	0.95	1.21	12.7	14.5	
AIRGAS ARG (3)	1045.4	15	122	5.3	7.7	223	28	0.6	1.9	0.00	0.42	0.79	0.93	6.5	10.0	
APPLIED INDUSTRIAL TECHNOLOGIES AIT (6)	353.3	18	-11	-0.7	8.4	115	14	0.2	1.7	2.62	1.50	1.41*	1.14	5.3	7.5	
ARROW ELECTRONICS ARW	2742.3	28	-4	16.5	1.6	149	120	0.2	3.3	0.00	3.62	0.66	0.75	14.7	12.5	
AVNET AVT (6)	2800.2	24	10	NM	-4.2	117	NM	0.2	NM	1.26	1.50	0.00*	-0.16	56.3	15.0	
BELL MICROPRODUCTS BELM	186.5	11	-30	39.4	-14.5	159	NM	0.1	NM	0.00	1.05	-0.28	0.36	5.6	15.0	
BRIGHTPOINT CELL	178.7	3	-9	20.5	-2.5	101	NM	0.1	NM	0.00	0.56	-0.01	0.35	0.0	20.0	
FISHER SCIENTIFIC INTERNATIONAL FSH	1472.1	27	-26	9.3	-24.0	NM	NM	0.5	1.8	0.00	0.51	1.01	1.55	0.7	15.0	
GENUINE PARTS GPC	5837.3	34	29	4.9	16.0	247	15	0.7	1.6	3.38	2.20	2.11	2.18	4.1	10.0	
GRAINGER (W.W.) GWW	4393.6	47	28	0.4	10.3	280	28	0.9	1.8	1.50	2.05	2.20	2.52	4.4	12.0	
PIONEER-STANOARO ELECTRONICS PIOS (3)	358.0	11	3	6.5	3.0	107	33	0.1	NM	1.06	1.12	-0.09	0.50	26.0	15.0	
PSS WORLD MEDICAL PSSI (3)	660.5	9	86	NM	-10.5	206	NM	0.4	2.7	0.00	-0.51	0.20	0.32	21.9	17.5	
RELIANCE STEEL & ALUMINUM RS	770.0	24	-1	15.9	7.9	133	14	0.5	1.3	0.98	2.28	1.26	1.27	28.4	15.0	
SCHEIN (HENRY) HSIC	1712.8	40	16	12.9	11.2	262	24	0.7	1.4	0.00	1.35	1.99	2.39	4.2	15.0	
UNITED STATIONERS USTR	986.1	29	17	23.6	12.0	188	16	0.3	0.8	0.00	2.84	2.52	3.45	2.6	15.0	
WESCO INTERNATIONAL WCC	204.2	5	-37	7.7	9.2	145	17	0.1	0.4	0.00	0.70	0.45	0.63	9.5	23.0	
(C) POLLUTION CONTROL																
GROUP AVERAGE	7878.4	2	-4	23.6	7.1	306	49	1.1	1.4	0.01	0.49	1.02	1.14	7.9	13.7	
ALLIED WASTE INDUSTRIES AW	2332.1	12	-19	NM	1.6	401	85	0.4	1.4	0.00	0.36	0.55	0.53	18.9	15.0	
REPUBLIC SERVICES RSG	2916.5	17	0	23.6	12.4	163	13	1.3	1.1	0.00	1.26	1.26	1.36	2.2	12.0	
WASTE MANAGEMENT WMI	18386.7	29	6	NM	7.4	353	48	1.6	1.7	0.03	-0.16	1.26	1.52	2.6	14.0	
(D) PRINTING & ADVERTISING																
GROUP AVERAGE	7110.1	43	-6	16.0	6.1	473	36	1.6	1.6	1.55	1.79	1.71	1.95	4.8	17.9	
BANTA BN	710.5	29	13	9.4	12.9	180	14	0.5	1.0	2.22	2.35	2.30	2.48	3.6	13.0	
OONNELLEY (R.R.) ONY	3355.0	29	9	15.4a	13.5	336	26	0.6	1.8	3.28	2.17	1.46	1.52	1.3	11.5	
INTERPUBLIC GROUP IPG	11002.4	29	-32	9.9	-27.5	590	NM	1.7	2.1	1.30	1.15	0.98	1.21	10.7	14.0	
OMNICOM GROUP OMC	15957.0	86	4	29.3	26.6	882	33	2.4	2.0	0.93	2.73	2.70	3.06	2.3	16.0	
TMP WORLDWIDE TMPW	4525.6	41	-25	NM	5.3	376	72	3.0	1.1	0.00	0.53	1.09	1.48	6.1	35.0	
(E) OTHER SERVICES																
GROUP AVERAGE	2693.8	20	48	25.3	8.9	340	23	1.0	2.0	0.77	1.01	0.84	1.12	15.6	16.3	
ABM INDUSTRIES ABM (10)	730.3	30	-1	15.0	13.1	203	16	0.4	1.4	2.19	1.85	1.80	2.10	2.4	12.3	
AOMINISTAFF ASF	805.3	29	7	50.8	15.5	723	50	0.2	1.4	0.00	0.58	0.69	0.87	8.1	30.0	
AUTONATION AN	3618.8	11	84	NM	7.7	93	13	0.2	1.1	0.00	0.91	0.86	1.00	2.0	12.0	
CARMAX GROUP KMX (2)	723.3	20	407	NM	15.4	161	31	0.3	1.2	0.00	0.43	0.74	0.93	2.2	22.5	
COI COI	334.7	18	20	-5.2	0.0	102	NM	0.2	5.9	0.00	1.73	0.20	0.24	33.3	15.0	
CENOANT CD	14615.5	17	77	22.4	15.9	248	15	1.8	1.1	0.00	0.89	1.02	1.23	2.4	15.0	
CINTAS CTAS (5)	7252.7	43	-20	15.2	17.7	563	32	3.3	1.7	0.51	1.30	1.40	1.65	2.4	18.0	
CONVERGYS CVG	5705.6	33	-27	22.4	11.7	489	41	2.5	1.1	0.00	1.23	1.38	1.57	4.5	22.5	
GROUP 1 AUTOMOTIVE GPI	603.4	31	233	NA	17.2	219	14	0.2	0.7	0.00	1.88	2.36	2.73	9.2	18.0	
IMS HEALTH RX	6052.2	20	-24	0.7	69.9	1986	29	4.5	1.0	0.39	0.39	0.99	1.17	2.6	20.0	
KELLY SERVICES KELYA	757.1	21	-11	6.2	6.4	124	19	0.2	4.7	1.89	2.43	0.45	0.44	93.2	10.0	
KPMG CONSULTING KGIN (6)	2630.2	17	NA	NA	-19.7	468	NM	0.9	NM	0.00	0.61	-1.19*	0.59	5.1	17.0	
LITHIA MOTORS LAO	251.3	20	57	20.0	10.8	132	13	0.1	NA	0.00	1.76	1.48	1.79	0.0	NA	
MAGELLAN HEALTH SERVICES MGL (9)	361.9	11	138	NM	9.5	230	20	0.2	2.2	0.00	0.41	0.59	0.76	1.3	8.0	
MANPOWER MAN	2476.6	33	14	3.4	19.1	310	16	0.2	1.4	0.61	2.22	1.61	1.57	7.0	15.0	
MOIS PROFESSIONAL SERVICES MPS	564.3	6	39	92.7	1.4	43	29	0.3	4.3	0.00	1.23	0.09	0.03	NA	15.0	
PANTRY PTRY (9)	105.8	6	42	NM	-2.3	91	NM	0.0	NM	0.00	0.74	-0.15*	1.10	31.8	19.0	
PAYCHEX PAYX (5)	13104.2	35	28	34.1	32.7	1606	49	7.3	2.0	1.26	0.68	0.77	0.92	3.3	23.0	
QUINTILES TRANSNATIONAL QTRN	1979.6	17	-21	NM	-17.1	140	NM	1.2	2.4	0.00	0.29	0.35	0.65	6.2	20.0	
REGIS RGIS (6)	989.1	24	63	14.5a	15.7	278	18	0.7	1.3	0.51	1.19	1.26*	1.53	0.7	14.5	
RENT-A-CENTER RCI	808.0	30	12	51.0	10.0	189	13	0.5	0.9	0.00	2.96	2.52	3.32	1.8	14.0	
ROBERT HALF INTERNATIONAL RHI	4679.4	27	2	20.4	20.1	601	31	1.8	2.0	0.00	1.00	0.69	0.65	13.9	20.0	
SERVICE CORP. INTERNATIONAL SRV	1710.4	6	235	NM	19.7	80	NM	0.7	4.1	0.00	1.56	0.19	0.21	38.1	7.5	

Mozart, Mountain Lakes and 4-Wheel Drive. Rethinking Your Image of a Great Business Location.

Form an image in your mind a moment. Think Austria. What do you see? Romantic, picture-postcard scenes of low mountains. The music of Mozart, altzes and traditional costumes. And can you really make any money from "Schuhatteln" ... whatever that is?

Now, rethink that image from another angle: standard of living! That may sound suspiciously like high ancillary wage costs. But one of the world's most prosperous countries, Austria boasts not only a scenic and cultural beauty, but also high levels of income, low crime rates and social stability. The point is that although our minds tend to hold on to images very firmly, they can sometimes be valuable to force ourselves to rethink those images from another perspective.

To take another example: try and think of an Austrian car model. None come to mind? Well, how about Austrians playing leading roles in the global automotive industry? Any outsider could instantly produce a "Who's Who" of top executives, engineers, and design innovators the length of your arm. What's why half the world uses BMW, General Motors and Chrysler engines and drivetrain technologies developed in Austria. What's why so many leading car manufacturers have developed 4-wheel drive versions here in Austria, and why many of them are assembled here too. That's also why so many major automotive suppliers have set up shop near the auto giants' Austrian facilities — and sprinkled among them, small but world-class specialists driving the development of next-generation Formula 1 technologies.

"Virtuous cycle" has been set in motion, with Austria's outstanding higher technical schools and universities feeding a generation of first-rate specialists into the local automotive industry, and in the process building related business sectors.

But cars, engines, drivetrains and suppliers are only one particularly striking example of the string of industry clusters forming across the country. Pharmaceuticals and information technologies have their own powerful presence.

Moreover, while no Austrian brand rolls off the tip of every child's tongue around the globe, Coke and McDonald's both have their central European headquarters in Austria. If you dig a little deeper, names will crop up that you'd find in a London supermarket (energy drinks) or in the finest boutiques around the world (glass figurines and wine glasses). And if you mention Austrian firms in textiles or furniture, railway and fire safety technologies or computer games, the respective experts will nod their heads appreciatively: "Right! That's the global leader."

So back to the subject of images: try this test. Get a photograph of Vienna's Donau-City. (If you don't happen to have one at hand, we'll be happy to send you one.) Show a friend the sea of skyscrapers surrounding the United Nations headquarters on the banks of the Danube. And whisper: "Vienna!" The resulting exchange will go something like this:

"Vienna?"

"Yep, Vienna."

"No way, this must be Houston or somewhere."

"No, it's Vienna!"

Of course, Vienna is a charming burg with breathtaking architecture from across the centuries. A cultural capital with theatres renowned worldwide — not to mention the largest museum quarter in all Europe.

But there is also a new Vienna, with skyscrapers, shopping malls, musical theatre, retail districts with rows and rows of flagship stores, hot clubs and cool restaurants offering Asian-Pacific cuisine.

Admittedly, you would find all this in other major cities, too. But senior executives know their teenagers will certainly prefer to live in a place where you can have it all — not just tradition and culture, but anything you can find in the trendiest magazines.

Now for one last image: water. Austria has a number of large lakes with water you cannot only swim in but even drink.

No nuclear plants ... but huge hydroelectric power stations. And the Danube, one of Europe's most important waterways with the largest container river port on the whole continent.

Given the rise of globalisation and our place in the heart of Euroland, we're making it a priority to clue the top performing companies in to the attractions of Austria as a business location. We're here to tell you all about the opportunities, the subsidies and the tax benefits ... to help you find sites, establish contacts, even to search for business partners. In short, to support you through the entire procedure of investigating and locating in Austria.

We know the competition is challenging: every European country is doing its best to tempt firms with subsidies and tax benefits.

But we know the very best businesses will be drawn to the very best business climate — and that's why we have an image of your company happily settled in Austria.

You can contact us in Vienna by
fax: +43-1-5868659
e-mail: office@aba.gv.at
internet: www.aba.gv.at

You can also send us the coupon below and order the photo of Donau-City for the aforementioned test.

P.S. We've had a few other things on our minds, too ... like Sisi, Blood Plasma and Aviation.

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EARNINGS PER SHARE

													2002 ESTIMATES FROM ANALYSTS				
COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	S EQ RAN
SERVICEMASTER	SVM	3664.5	12	6	6.7	10.4	308	29	0.8	2.5	3.28	0.61	0.49	0.61	9.8	10.0	A
SONIC AUTOMOTIVE	SAH	800.7	20	189	86.1a	14.4	163	12	0.1	0.7	0.00	1.69	1.81	2.24	4.9	15.0	M
SPHERION	SFN	523.0	9	-21	13.3	8.6	40	5	0.2	2.8	0.00	1.16	0.24	0.16	75.0	13.5	M
STAFF LEASING	GVHR	35.0	2	-43	NM	-21.2	58	NM	0.0	NM	11.76	0.03	-0.34	-0.21	9.5	20.0	M
UNITED RENTALS	URI	1595.6	22	62	10.4	7.9	100	16	0.5	1.0	0.00	1.89	1.53	1.87	9.1	15.0	M
US ONCOLOGY	USON	641.5	6	1	NM	-13.7	97	NM	0.4	0.8	0.00	-0.72	0.52	0.73	56.2	15.0	M

22 TELECOMMUNICATIONS

INDUSTRY AVERAGE		25147.4	24	-36	16.9	-11.8	295	25	1.7	2.7	1.33	0.37	-0.08	0.26	58.4	16.9	
(A) EQUIPMENT & SERVICES																	
GROUP AVERAGE		13741.9	20	-39	14.6	-18.0	299	26	1.5	2.7	1.20	-0.26	-0.62	-0.22	65.7	18.4	
AOC TELECOMMUNICATIONS ADCT (10)		3504.5	4	-76	NM	-68.0	185	NM	1.5	NM	0.00	1.13	-1.64*	-0.12	33.3	19.0	
AT&T T		61841.2	17	1	-19.0	-16.2	118	NM	1.1	13.9	0.86	0.88	0.18	0.23	52.2	7.0	
AT&T WIRELESS SERVICES AWE		29672.3	14	-19	NA	2.3	145	58	2.3	NM	0.00	0.21	-0.09	0.03	433.3	30.0	
CENTURYTEL CTL		4768.8	34	-5	14.5	15.3	209	14	2.3	2.0	0.59	1.63	1.56	1.73	2.9	11.0	
CITIZENS COMMUNICATIONS CZN		2741.6	10	-25	NM	0.4	138	NM	1.2	NM	0.00	-0.15	-0.05	0.06	283.3	20.0	
CONVERSE TECHNOLOGY CMVT (1)		3967.0	21	-80	NA	15.0	240	16	2.9	1.2	0.00	1.39	0.92	0.76	21.1	20.0	
CORNING GLW		8694.5	9	-82	-0.5	-81.4	144	NM	1.2	1.1	0.00	0.46	0.44	-0.34	41.2	20.0	
GLOBAL CROSSING GX		1127.3	1	-91	NM	-45.2	16	NM	0.3	NM	0.00	-1.92	-3.13	-3.26	10.7	20.0	
LUCEENT TECHNOLOGIES LU (9)		24991.7	7	-46	NM	NM	227	NM	1.2	NM	0.00	0.43	-4.18*	-0.40	32.5	15.0	
MCI GROUP MCIT		1551.2	13	NA	NA	7.7	63	NA	0.1	2.5	18.31	NA	1.76	0.45	142.2	3.0	
NEXTEL COMMUNICATIONS NXTL		8546.6	11	-57	NM	-49.2	951	NM	1.2	NM	0.00	-1.21	-2.00	-1.48	23.7	30.0	
NTL NLI		511.7	2	-92	NM	-58.3	10	NM	0.1	NM	0.00	-14.54	-13.82	-10.88	21.8	30.0	
SCIENTIFIC-ATLANTA SFA (6)		4196.7	27	-17	51.6	19.1	310	17	1.8	1.2	0.15	0.94	1.99*	1.04	15.4	11.5	
SPRINT FON GROUP FON		21517.6	22	7	-2.6	6.8	169	22	1.2	2.1	2.29	1.45	1.30	1.43	11.9	8.0	
SPRINT PCS GROUP PCS		25079.7	25	22	NM	-84.7	2108	NM	2.8	NM	0.00	-1.95	-1.23	-0.41	48.8	30.0	
TELEPHONE & DATA SYSTEMS TOS		5266.4	90	0	3.2	-6.9	156	NM	2.1	1.4	0.60	2.39	2.75	3.27	10.1	24.0	
TELLABS TLAB		6264.6	15	-73	54.1	7.5	244	34	2.2	2.3	0.00	1.82	0.34	0.27	33.3	20.0	
U.S. CELLULAR USM		3828.7	44	-26	15.7	8.1	167	21	2.1	1.1	0.00	2.68	2.13	2.34	14.1	18.7	
WORLDCOM GROUP WCOM		43024.2	15	NA	NA	3.0	78	NA	2.0	1.2	0.00	NA	1.01	1.04	17.3	12.0	

(B) TELEPHONE COMPANIES

GROUP AVERAGE		61264.8	35	-27	21.3	6.9	283	23	2.0	2.6	1.75	2.14	1.63	1.77	35.0	12.2	
ALLTEL AT		20201.6	65	4	47.5	19.8	372	19	2.7	2.0	2.09	6.20	2.83	3.13	4.2	11.5	
BELLSOUTH BLS		72264.5	39	-6	11.8	16.1	401	25	3.0	2.0	1.97	2.23	2.21	2.40	2.9	8.7	
BROADBOWING BRW		2074.6	10	-58	NM	-19.7	119	NM	0.9	NM	0.00	-1.82	-0.73	-0.68	39.7	15.0	
QWEST COMMUNICATIONS INTL. Q		19813.5	12	-71	NM	-9.5	53	NM	1.0	4.9	0.42	-0.06	0.11	0.12	158.3	22.0	
SBC COMMUNICATIONS SBC		125655.2	37	-22	8.9	22.5	386	17	2.7	2.0	2.74	2.32	2.33	2.42	2.5	8.0	
VERIZON COMMUNICATIONS VZ		127579.3	47	-6	16.9	12.4	366	30	1.9	2.0	3.28	3.95	3.01	3.25	2.2	8.0	

23 TRANSPORTATION

INDUSTRY AVERAGE		4751.3	26	-7	4.9	0.6	194	33	0.6	2.4	0.73	1.63	-1.97	-0.29	53.6	11.6	
(A) AIRLINES																	
GROUP AVERAGE		2643.2	18	-44	6.5	-11.5	105	19	0.4	3.1	0.16	1.88	-9.43	-5.09	70.3	9.4	
ALASKA AIR GROUP ALK		760.0	29	-4	NM	-3.7	88	NM	0.3	NM	0.00	-0.51	-2.81	-1.05	92.4	8.0	
AMERICA WEST HOLDINGS AWA		87.6	3	-80	1.2	-22.1	15	NM	0.0	NM	0.00	0.22	-5.73	-2.93	27.0	10.0	
AMR AMR		3299.7	21	-45	-4.7	-14.7	53	NM	0.2	NM	0.00	4.81	-8.66	-4.20	32.9	10.0	
AMTRAN AMTR		138.4	12	-17	NM	-11.3	111	NM	0.1	NM	0.00	-1.31	-4.57	-0.97	253.6	8.0	
CONTINENTAL AIRLINES CAL		1265.7	23	-55	-0.7	7.8	101	14	0.1	NM	0.00	5.54	-5.64	-2.63	107.6	10.0	
DELTA AIR LINES DAL		3571.8	29	-42	46.1	-9.8	77	NM	0.2	NM	0.35	7.05	-8.11	-2.76	76.5	8.0	
NORTHWEST AIRLINES NWAC		1528.7	18	-41	-11.6	NM	NM	NM	0.1	NM	0.00	2.77	-6.38	-2.88	19.8	10.0	
SOUTHWEST AIRLINES LUV		14350.2	19	-16	31.4	15.3	363	25	2.5	3.1	0.00	0.79	0.45	0.63	9.5	13.5	
UAL UAL		919.4	17	-57	-16.4	-53.7	30	NM	0.1	NM	1.19	1.89	-36.54	-24.18	38.8	8.0	
US AIRWAYS GROUP U		510.3	7	-82	NM	NM	NM	NM	0.1	NM	0.00	-2.47	-16.33	-9.95	45.0	8.0	

(B) RAILROADS

GROUP AVERAGE		10119.4	35	26	-14.3	7.1	137	22	1.1	1.8	1.35	1.76	2.05	2.51	6.9	10.3	
BURLINGTON NORTHERN SANTA FE BNTF		11357.5	29	4	5.1	10.5	146	14	1.2	1.6	1.64	2.36	2.07	2.34	3.9	9.0	
CSX CSX		7972.3	37	44	-31.7	4.6	130	28	1.0	2.0	1.07	0.88	1.60	2.41	10.0	12.0	
NORFOLK SOUTHERN NSC		7474.3	19	46	-31.0	4.2	124	30	1.2	2.5	1.24	0.45	0.86	1.14	8.8	9.0	
UNION PACIFIC UNP		13673.7	55	8	0.3	9.2	148	16	1.2	1.4	1.45	3.34	3.65	4.15	4.8	11.0	

(C) TRANSPORTATION SERVICES

GROUP AVERAGE		2369.0	26	-3	-1.6	0.1	235	61	0.5	2.7	1.32	0.73	0.79	1.37	72.7	14.1	
AIRBORNE ABF		646.3	13	38	-17.3	-4.0	77	NM	0.2	NM	1.19	0.30	-0.77	-0.07	585.7	12.0	
CNF CNF		1241.9	25	-25	16.0	-21.7	144	NM	0.2	9.6	1.57	2.65	0.22	1.23	27.6	12.0	
EGL EAGL		737.0	15	-37	NM	-17.7	200	NM	0.3	NM	0.00	-0.02	0.60	0.45	31.1	20.0	
EXPEDITORS INTL. OF WASHINGTON EXPO		2619.1	50	-7	34.2	22.5	612	29	1.6	1.4	0.40	1.52	1.77	1.99	4.5	20.0	
FEDEX FOX (5)		13671.9	46	15	31.8	9.0	227	25	0.7	1.8	0.00	1.99	1.94	2.45	7.8	13.0	
GATX GMT		1371.2	28	-44	-24.1	-6.3	150	NM	0.9	1.7	4.40	0.63	1.28	2.41	14.1	13.0	
HUB GROUP HUBG		75.2	10	8	-19.2	0.3	56	195	0.1	0.8	0.00	0.60	0.94	1.13	15.9	13.5	
PITTSBURGH P28		1118.5	21	4	-55.6	-1.3	224	NM	0.3	1.8	0.49	0.05	0.78	1.42	28.2	14.8	
ROBINSON (C.H.) WORLWIDE CHRW		2348.5	28	12	21.1	24.0	686	29	0.8	1.7	0.86	0.83	0.98	1.12	2.7	17.0	

The #1 Equity Income Fund

T. Rowe Price Equity Income Fund (PRFDX) was ranked #1 out of 20 equity income funds since its inception, 10/31/85, through 9/30/01 by Lipper.

For more than 15 years, the fund has been committed to rewarding investors with above-average dividend income and capital growth—at a low level of risk relative to other stock funds. It has done this by investing in stocks of large established companies that appear to be undervalued in the marketplace. As other investors recognize their true worth, these stocks offer potential for substantial appreciation. This approach also helps reduce downside risk since these stocks are already selling at relatively low prices and many offer reliable dividends, which are a positive component of total return.

As the chart shows, this strategy has proven highly effective. The fund has outperformed its peers and has also received an Overall Morningstar Rating™ of five stars for its risk-adjusted performance.

Although the fund aims for long-term capital appreciation with less risk than other stock funds, it is still subject to the inherent volatility of the stock market. Past performance cannot guarantee future results, and there is no assurance the fund will retain its #1 ranking. When assessing performance, investors should consider both short- and long-term returns. For updated performance information, please visit our Web site or contact a T. Rowe Price representative. 100% no load.

To learn more, request a fund profile or prospectus.

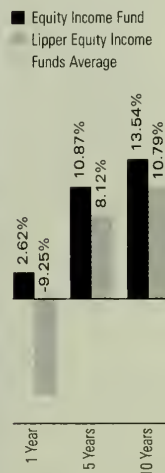
Overall Morningstar Rating™

★★★★★

The fund was rated among 4,673; 2,960; and 881 domestic equity funds for the 3-, 5-, and 10-year periods ended 10/31/01, respectively.*

Performance Versus Competitors

Average annual total returns as of 9/30/01



1 - 8 0 0 - 5 4 1 - 6 1 3 9

W W W . T R O W E P R I C E . C O M

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Average annual total return figures include changes in principal value, reinvested dividends, and capital gain distributions. Investment return and principal value will vary, and shares may be worth more or less at redemption than at original purchase. (Source for data: Lipper Inc.)

*For each fund with at least a 3-year history, Morningstar calculates a Morningstar Rating™ metric each month by subtracting the return on a 90-day U.S. Treasury bill from the fund's load-adjusted return for the same period and then adjusting this excess return for risk. The top 10% of funds in each broad asset class receive 5 stars, the next 22.5% receive 4, the next 35% receive 3, the next 22.5% receive 2, and the bottom 10% receive 1. The Overall Morningstar Rating™ for a fund is derived from the weighted average of the performance figures associated with its 3-, 5-, and 10-year (if applicable) Morningstar Rating™ metrics. Each fund is rated exclusively against U.S.-domiciled domestic equity funds. Morningstar Rating™ is for retail share class only; other classes may have different performance characteristics. The Equity Income Fund received 4, 4, and 5 stars for the 3-, 5-, and 10-year periods, respectively. Based on its total return, Lipper also ranked this fund #18 out of 200, #21 out of 128, and #5 out of 44 equity income funds for the 1-, 5-, and 10-year periods ended 9/30/01, respectively. For more information, including fees, expenses, and risks, read the fund profile or prospectus carefully before investing. T. Rowe Price Investment Services, Inc., Distributor.

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EARNINGS PER SHARE

2002 ESTIMATES FROM ANALYSTS

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %
RYOER SYSTEM R	1243.2	21	23	NM	3.7	100	27	0.2	1.4	2.93	1.49	1.50	1.55	9.0	10.0
TRINITY INDUSTRIES TRN (3)	986.4	27	7	NM	-7.3	112	NM	0.6	4.1	2.70	-1.98	0.65	NA	NA	10.0
(D) TRUCKING & SHIPPING															
GROUP AVERAGE	7619.5	31	15	24.4	9.1	248	23	0.5	2.1	0.35	2.40	1.15	1.97	34.6	11.5
ARKANSAS BEST ABFS	594.9	24	33	NM	15.5	183	11	0.4	2.3	0.00	3.17	1.53	2.10	5.7	7.0
CONSOLIDATED FREIGHTWAYS CFWY	87.4	4	-5	NM	-39.4	47	NM	0.0	NM	0.00	-0.35	-3.85	-0.95	232.6	5.0
HUNT (J.B.) TRANSPORT SERVICES J8HT	643.9	18	6	15.2	5.7	143	25	0.3	3.7	0.00	1.02	0.48	0.89	20.2	10.0
LANOSTAR SYSTEM LSTR	561.2	69	25	35.2	45.0	535	13	0.4	0.9	0.00	5.03	5.28	6.17	4.4	15.0
ROADWAY ROAD	611.0	30	40	29.4	12.2	175	13	0.2	1.7	0.67	2.98	1.79	2.54	11.4	10.0
SWIFT TRANSPORTATION SWFT	1723.3	20	2	14.1	3.4	243	61	0.9	2.4	0.00	0.82	0.46	0.82	12.2	18.2
UNITED PARCEL SERVICE UPS	62850.2	56	-4	25.3	25.8	648	26	2.1	2.0	1.35	2.50	2.06	2.27	5.3	14.0
USFREIGHTWAYS USFC	897.9	34	13	27.1	7.8	134	17	0.4	1.4	1.10	3.61	1.66	2.08	4.8	15.0
YELLOW YELL	606.1	24	20	NM	6.1	124	20	0.2	2.9	0.00	2.79	0.93	1.79	15.1	9.0

24 UTILITIES & ENERGY SERVICES

INDUSTRY AVERAGE	5064.4	29	-16	8.9	11.1	170	16	0.7	3.3	3.93	1.75	2.41	2.59	5.3	9.2
(A) ELECTRIC, WATER & COGENERATION															
GROUP AVERAGE	5383.8	29	-16	9.6	10.0	161	16	0.7	3.9	4.20	1.80	2.52	2.69	5.2	8.7
AES AES	8806.1	17	-70	36.8	8.6	172	19	1.0	0.7	0.00	1.42	1.28	1.55	3.9	19.0
ALLEGHENY ENERGY AYE	4351.4	35	-28	13.2	16.7	161	9	0.5	0.9	4.94	2.84	3.90	4.17	2.6	10.0
ALLIANT ENERGY LNT	2229.8	28	-12	23.5	10.5	139	12	0.8	2.9	7.12	4.82	2.42	2.60	0.4	4.0
AMEREN AEE	5622.6	41	-12	5.3	12.6	168	12	1.3	2.4	6.21	3.33	3.37	3.44	4.4	5.0
AMERICAN ELECTRIC POWER AEP	13290.8	41	-11	-23.8	8.5	159	18	0.3	1.7	5.82	0.94	3.56	3.84	1.0	7.0
AMERICAN WATER WORKS AWK	4123.9	41	40	6.3	9.4	236	25	2.9	3.9	2.28	1.61	1.77	1.89	1.1	6.0
AQUILA ILA	1820.0	18	NA	21.7	29.5	239	7	0.1	0.3	0.00	1.14	2.32	2.05	3.4	25.0
AVISTA AVA	570.4	12	-41	2.5	16.9	78	4	0.1	2.4	4.00	1.47	1.25	0.68	44.1	4.0
BLACK HILLS BKH	815.2	31	-31	14.3	20.2	163	7	0.4	0.5	3.64	2.37	3.81	2.70	4.4	15.0
CALPINE CPN	6579.3	22	-52	61.7	22.7	228	11	1.0	0.4	0.00	1.16	2.04	2.50	5.2	30.0
CINERGY CIN	4690.2	29	-16	4.3	14.3	161	11	0.4	1.7	6.11	2.50	2.75	2.90	1.4	6.5
CMS ENERGY CMS	3062.5	23	-27	NA	-19.2	154	NM	0.2	1.8	6.34	0.36	1.78	2.03	3.9	7.1
CONECTIV CIV	2127.0	24	20	1.9	26.9	169	5	0.4	3.3	3.67	1.91	1.81	2.05	2.0	4.0
CONSOLIDATED EDISON ED	8195.4	39	0	-1.6	10.2	145	14	0.8	2.8	5.70	2.74	3.23	3.35	1.2	4.3
CONSTELLATION ENERGY GROUP CEG	3888.1	24	-47	5.6	10.0	95	9	1.0	1.4	2.02	2.30	2.61	2.69	6.7	6.5
DOMINION RESOURCES D	14548.8	58	-13	-10.2	9.5	192	19	1.3	1.4	4.41	1.76	4.17	4.90	1.4	10.0
OPL DPL	2972.8	24	-29	18.0	40.5	355	9	2.3	1.3	4.00	2.14	1.87	2.01	4.5	10.0
OGE OGE	984.8	18	-46	-1.4	-9.4	165	NM	0.8	2.4	9.53	2.15	1.21	1.61	6.2	6.0
OTE ENERGY DTE	6724.1	41	6	11.3	5.5	149	24	0.9	1.7	4.99	3.27	3.50	4.05	1.7	7.0
DUKE ENERGY DUK	28052.4	36	-15	13.3	16.0	224	14	0.4	1.0	3.04	2.38	2.75	2.84	3.2	13.0
EOISON INTERNATIONAL EIX	4919.7	15	-3	NM	NM	449	NM	0.4	1.3	0.00	-5.84	1.31	1.57	1.9	9.0
ENERGY EAST EAS	2122.1	18	-8	14.8	9.8	122	12	0.5	1.1	5.05	2.07	2.13	2.22	12.2	8.0
ENTERGY ETR	8155.4	37	-13	13.2	9.5	109	11	0.8	1.2	3.58	2.97	3.16	3.44	1.5	10.0
EXELON EXC	14314.7	45	-36	5.8	14.4	183	13	1.0	1.7	3.79	2.77	4.36	4.62	2.4	6.0
FIRSTENERGY FE	7566.1	34	7	6.4	11.2	159	12	1.0	1.7	4.44	2.69	2.89	3.28	6.4	7.0
FPL GROUP FPL	9743.1	55	-23	5.6	11.7	163	13	1.2	1.7	4.04	4.14	4.69	4.97	1.2	7.0
HAWAIIAN ELECTRIC INDUSTRIES HE	1266.0	37	1	-14.7	6.4	144	22	0.7	3.4	6.63	1.40	3.16	3.29	4.0	3.5
MIRANT MIR	8308.0	24	-14	43.7	12.6	177	14	0.3	0.5	0.00	1.15	1.97	2.57	3.5	24.0
NIAGARA MOHAWK HOLOINGS NMK	2842.7	18	6	NM	-3.0	109	NM	0.6	118.3	0.00	-0.27	0.03	0.24	4.2	5.0
NISOURCE NI	4322.0	21	-32	-6.7	4.5	127	28	0.4	1.9	5.55	1.08	1.60	2.10	5.7	7.0
NORTHEAST UTILITIES NU	2313.7	17	-28	48.3	12.0	108	9	0.4	2.6	2.87	1.45	1.34	1.51	4.0	5.0
NORTHWESTERN NOR	483.8	20	-12	10.2	14.4	146	10	0.1	1.1	6.23	1.87	2.03	2.31	4.3	9.5
NRG ENERGY NRG	3359.2	17	-39	67.4	12.3	155	12	1.2	0.5	0.00	1.10	1.39	1.68	4.2	23.0
NSTAR NST	2293.2	43	1	5.2	1.0	181	188	0.7	1.8	4.76	3.18	3.52	3.75	1.1	7.0
OGE ENERGY OGE	1704.2	22	-11	3.9	10.5	156	15	0.5	3.0	6.08	1.89	1.46	1.84	2.7	5.0
PG&E PCG	6649.4	18	-9	NM	-84.3	180	NM	0.3	0.9	0.00	-9.18	2.64	2.76	11.2	8.0
PINNACLE WEST CAPITAL PNW	3533.9	42	-12	10.3	13.4	142	11	0.8	1.3	3.83	3.56	3.95	4.05	2.2	8.0
POTOMAC ELECTRIC POWER POM	2267.7	21	-15	12.9	17.5	121	7	0.9	2.0	4.74	2.96	1.88	2.06	4.4	5.5
PPL PPL	5194.4	36	-21	13.2	25.1	223	9	0.9	0.9	2.98	3.37	4.14	4.17	1.9	10.0
PROGRESS ENERGY PGN	9066.7	41	-16	3.4	9.9	146	14	1.2	1.8	5.11	3.03	3.39	4.01	1.8	7.0
PUBLIC SERVICE CO. OF NEW MEXICO PNM	1017.1	26	-3	10.1	15.1	98	6	0.4	1.0	3.08	2.53	4.24	3.14	4.8	6.0
PUBLIC SERVICE ENTERPRISE GROUP PEG	8433.3	41	-17	10.1	18.6	205	11	0.9	1.6	5.33	3.55	3.68	4.02	1.2	7.0
PUGET ENERGY PSD	1682.0	19	30	5.9	11.7	122	10	0.4	2.7	9.48	2.16	1.29	1.36	37.5	5.5
RELIANT ENERGY REI	7614.4	26	-41	12.9	11.6	114	10	0.2	0.9	5.87	2.68	3.19	2.60	30.4	9.0
RELIANT RESOURCES RRI	4737.4	16	NA	NA	5.5	75	NA	0.1	0.5	0.00	NA	1.68	2.07	3.9	20.0
RGS ENERGY GROUP RGS	1327.0	38	18	3.0	9.4	170	17	0.8	6.1	4.70	2.60	2.53	2.70	NA	2.5
SCANA SCG	2829.8	27	-9	0.8	26.1	133	5	0.7	2.4	4.44	2.12	2.22	2.40	0.0	5.0
SIERRA PACIFIC RESOURCES SRP	1510.9	15	-8	NM	0.3	88	NM	0.3	2.9	5.41	-0.63	0.93	1.69	3.6	5.5
SOUTHERN SO	15793.6	23	-32	-0.7	12.8	198	15	1.5	2.8	5.89	1.52	1.61	1.72	1.7	5.0
TECO ENERGY TE	3592.7	26	18	4.3	15.8	192	12	1.4	1.5	5.23	1.97	2.28	2.41	2.9	8.0
TXU TXU	11947.3	45	2	0.6	10.4	148	13	0.4	1.4	5.32	3.43	3.69	4.39	1.1	9.0
UTILICORP UNITED UCU	2971.7	26	-17	10.9	12.8	113	9	0.1	1.0	4.67	2.21	2.42	2.85	3.9	11.0

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EARNINGS PER SHARE

2002 ESTIMATES FROM ANALYSTS

COMPANY	STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2001 PRICE CHANGE %	EARNINGS GROWTH 1996-2000 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	P-E TO GROWTH RATE	YIELD %	2000 ACTUAL	2001 ANALYST EST.	CONSENSUS	VARIATION %	LONG-TERM GROWTH RATE %	5-YR. AVG. RETURN %
WESTERN RESOURCES	WR	1220.8	17	-30	-14.3	-3.0	65	NM	0.5	1.9	6.96	1.30	1.80	1.78	5.6	5.0	
WISCONSIN ENERGY	WEC	2545.2	22	-3	-10.2	9.6	123	13	0.6	2.7	3.66	1.27	2.02	2.24	4.0	4.0	
WPS RESOURCES	WPS	968.2	34	-8	6.2	10.5	156	13	0.3	3.3	6.23	2.53	2.56	2.75	1.5	4.0	
XCEL ENERGY	XEL	9419.6	27	-6	-2.9	12.4	152	12	0.6	1.5	5.49	1.60	2.30	2.48	1.2	8.0	
(B) GAS, OIL & ENERGY SERVICES																	
GROUP AVERAGE		4122.9	29	-17	6.8	14.3	197	15	0.7	1.6	3.15	1.61	2.09	2.28	5.5	10.6	
ATMOS ENERGY ATO (9)		799.5	20	-20	16.1	9.6	137	13	0.6	2.2	6.02	1.14	1.47*	1.58	2.5	6.0	
DYNEGY DYN		9884.6	30	-46	20.9	16.4	240	15	0.2	0.7	0.99	1.48	2.10	2.56	3.1	20.0	
EL PASO EPG		22706.4	45	-38	-5.9	-2.0	273	NM	0.4	0.9	1.91	2.44	3.33	3.67	1.9	15.0	
EQUITABLE RESOURCES EQT		2081.7	33	-3	21.0	19.0	248	14	1.0	1.5	1.97	1.60	2.28	2.51	4.0	9.3	
KEYSPAN KSE		4600.4	33	-22	-1.2	7.9	157	19	0.7	1.3	5.37	2.10	2.53	2.85	5.3	10.0	
KINDER MORGAN KMI		5492.3	49	-6	19.1	13.8	299	23	3.2	1.3	0.41	1.60	1.91	2.48	1.6	20.0	
MDU RESOURCES GROUP MDU		1698.2	25	-24	14.4	14.9	158	10	0.7	1.1	3.75	1.80	2.20	2.07	4.4	10.0	
NATIONAL FUEL GAS NFG (9)		1772.6	22	-29	-13.8	6.0	162	27	0.8	3.4	4.51	1.61	0.82*	1.78	3.4	8.0	
NICOR GAS		1745.2	39	-10	-19.6	19.1	243	13	0.6	2.1	4.52	1.00	3.04	3.21	0.9	6.0	
ONEOK OKE		1026.9	17	-29	17.2	9.2	80	11	0.1	1.3	3.60	1.46	1.34	1.47	5.4	10.0	
PEOPLES ENERGY PGL (9)		1360.0	38	-14	-0.6	11.7	163	14	0.6	2.3	5.31	2.44	2.74*	3.30	3.3	6.0	
PLAINS RESOURCES PLX		565.4	24	15	7.3	47.9	237	6	0.3	0.5	0.00	1.56	2.31	2.15	6.5	20.0	
QUESTAR STR		1894.4	23	-23	12.9	16.2	182	11	1.2	1.5	3.10	1.94	1.89	1.87	5.4	8.5	
SEMPRA ENERGY SRE		4798.7	23	0	3.9	17.1	174	9	0.5	1.0	4.32	2.06	2.51	2.68	1.5	9.0	
SOUTHERN UNION SUG (6)		936.5	18	-31	NA	6.0	138	25	0.5	3.4	0.00	0.21	1.03*	0.63	28.6	5.0	
UGI UGI (9)		801.5	29	16	4.9	17.5	288	16	0.3	2.2	5.43	1.64	1.90*	2.64	6.1	7.0	
VECTREN VVC		1435.3	21	-17	-3.5	7.5	175	22	0.6	1.7	5.00	1.17	1.43	1.93	2.1	8.5	
WESTERN GAS RESOURCES WGR		975.3	30	-11	22.2	18.7	197	11	0.3	1.5	0.67	1.44	2.38	1.26	16.7	8.5	
WILLIAMS WMB		13760.8	27	-33	NA	16.1	185	11	1.2	0.7	2.99	1.95	2.41	2.73	1.8	15.0	

ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

A	American Management Systems 18c	B	Broadwing 22b	Coca-Cola 6c	Cypress Semiconductor 9d	Edison International 24a
A&P 10c	American Power 9a	Baker Hughes 11b	Brown-Forman 6c	Coca-Cola Enterprises 6c	Cytec Industries 4	Edwards (A.G.) 17a
Abbott Laboratories 12b	American Standard 13a	Ball 7a	Brunswick 14d	Colgate-Palmolive 6d		EGL 23c
Abercrombie & Fitch 8	American Water Works 24a	BancWest 3d	Burlington Coat Factory 8	Collins & Aikman 15d	D	El Paso 24b
ABM Industries 21e	AmerisourceBergen 12a	Bank of America 3c	Burlington Northern Santa Fe 23b	Colonial BancGroup 3a	D&K Healthcare Resources 12a	Electronic Arts 18c
ACT Mfg. 9d	Amgen 12b	Bank of New York 3a	Burlington Resources 11a	Comcast 20a	Dana 2b	Electronic Data Systems 18
ADC Telecomm. 22a	Amkor Technology 9d	Bank One 3b		Cornier 3b	Danaher 9c	EMC 18b
Adelphia Communications 20a	Amphenol 9d	BankNorth Group 3a		Commerce Bancorp 3a	Darden Restaurants 14a	Emcor Group 21a
Administaff 21e	AMR 23a	Banta 21d	C	Commerce Bancshares 3b	DaVita 12c	Emerson Electric 9a
Adobe Systems 18c	AmSouth Bancorporation 3c	Barnes & Noble 8	Cablevision Systems 20a	Community Health Sys. 12c	Dean Foods 10b	Encompass Services 21a
Advanced Micro 9d	Amtran 23a	Bausch & Lomb 12d	Cabot 4	Compaq Computer 18b	Deere 15c	Engraver Holdings 15a
AdvancePCS 17a	Anadarko Petroleum 11a	Baxter International 12d	Cadence Design Systems 18c	Compass Bancshares 3c	Del Monte Foods 10b	Energy East 24a
AES 24a	Analog Devices 9d	BB&T 3c	Calpine 24a	CompuCom Systems 18b	Dell Computer 18b	Engelhard 16c
Aetna 12c	Anheuser-Busch 6c	Bear Stearns 17a	Campbell Soup 10b	Computer Associates 18c	Delphi Automotive 2b	Entergy 24a
Affiliated Computer Svcs. 18c	Amixter International 5	Beazer Homes USA 13b	Cardinal Health 12a	Computer Sciences 18c	Delta Air Lines 23a	EOG Resources 11a
AFLAC 17b	AnnTaylor Stores 8	Beckman Coulter 9c	Caremark Rx 12a	Compuware 18c	Devon Energy 11a	Equifax 17a
AGCO 15c	Anthem 12c	Becton, Dickinson 12d	Carlisle 15a	Converse Tech. 22a	Dial 6d	Equitable Resources 24b
Agere Systems 9d	AOL Time Warner 18c	Bed Bath & Beyond 6b	CarMax Group 21e	ConAgra Foods 10b	Diebold 18a	Equity Office Properties 13b
Agilent Technologies 9c	Aon 17b	Bell Microproducts 21b	Carnival 14d	Concord EFS 17a	Dillard's 8	Equity Residential 13b
Air Products & Chemicals 4	Apache 11a	BellSouth 22b	Carpenter Tech. 16b	Connectiv 24a	Dime Bancorp 17c	Estee Lauder 6d
Airborne 23c	Apple Computer 18b	Belo 20b	Caterpillar 15c	Conexant Systems 9d	DiMon 6e	Everest Re Group 17b
Airgas 21b	Applied Biosystems 9c	Bemis 7b	CBRL Group 14a	Conoco 11a	Disney (Walt) 20a	Exelon 24a
AK Steel Holding 16b	Applied Industrial Tech. 21b	Benchmark Electronics 9d	CDI 21e	Conoco 17b	Dole Food 10b	Expeditors Intl. 23c
Alaska Air Group 23a	Applied Materials 15c	Berkley (W.R.) 17b	CDW Computer Centers 8	Consolidated Edison 24a	Dollar Tree Stores 8	Express Scripts 12c
Alberto-Culver 8	Aquila 24a	Berkshire Hathaway 17a	Cendant 21e	Cons. Freightways 23d	Dominion Resources 24a	Exxon Mobil 11a
Albertson's 10c	Arch Coal 11a	Best Buy 6b	Centex 13b	Constellation Brands 6c	Donnelley (R.R.) 21d	
Alcoa 16a	Arch Chemicals 10b	Beverly Enterprises 12c	CenturyTel 22a	Constellation Energy 24a	Dover 15c	F
Allegheny Energy 24a	Arkansas Best 23d	Big Lots 8	Champion Enterprises 13b	Continental Airlines 23a	Dow Chemical 4	Fairchild Semiconductor 9d
Allegheny Tech. 5	Arrow Electronics 21b	BJ Services 11b	Charming Shoppes 8	Convergys 21e	Dow Jones 20b	Farm Family Stores 8
Allergan 12b	ArvinMeritor 2b	BJ's Wholesale Club 8	Charter Communications 20a	Cooper Cameron 11b	DPL 24a	Fannie Mae 17a
Alliant Energy 24a	Ashland 11a	Black & Decker 15b	Charter One Financial 17c	Cooper Industries 9a	DQE 24a	Federal-Mogul 2b
Allied Waste Inds. 21c	Associated Banc-Corp 3a	Black Hills 24a	ChevronTexaco 11a	Cooper Tire & Rubber 2c	DST Systems 18c	Federated Dept. Stores 8
Allmerica Financial 17b	Astoria Financial 17c	Block (H&R) 17a	Chubb 17b	Coors (Adolph) 6c	DTE Energy 24a	FedEx 23c
Allstate 17b	AT&T 22a	Blockbuster 14b	Cigna 17b	Corn Products Intl. 10b	Duke Energy 24a	Ferro 4
Alltel 22b	AT&T Wireless 22a	BMC Software 18c	Cincinnati Financial 17b	Corning 22a	Dun & Bradstreet 17a	Fidelity National Finl. 17a
Altera 9d	Atmel 9d	Boeing 1	Cinergy 24a	Costco Wholesale 8	DuPont 4	Fifth Third Bancorp 3b
Amazon.com 8	Atmos Energy 24b	Boise Cascade 19b	Cintas 21e	Countrywide Credit 17a	Dura Automotive Systems 2b	First American 17a
Amerada Hess 11a	Autoliv 2b	BOK Financial 3d	Circuit City Group 6b	Coventry Health Care 12c	Dynegy 24b	First Data 18c
Ameren 24a	Automatic Data 18c	Borders Group 8	Cisco Systems 18c	Cox Communications 20a		First Tennessee Natl. 3c
America West Holdings 23a	AutoNation 21e	BorgWarner 2b	Citigroup 17a		E	First Virginia Banks 3c
American Axle & Mfg. 2b	AutoZone 8	Boston Scientific 12d	Citizens Communs. 22a	Crane 15c	E*Trade Group 17a	FirstEnergy 24a
American Electric 24a	Avaya 9b	Bowater 19b	City National 3d	Crompton 4	Eastman Chemical 4	FirstMerit 3b
American Express 17a	Avery Dennison 15a	Briggs & Stratton 15c	Clear Channel Communs. 20a	Crown Cork & Seal 7a	Eastman Kodak 14d	Fisher 18c
American Financial Group 17b	Avista 24a	Brightpoint 21b	Clorox 6d	CSK Auto 8	Eaton 2b	Fisher Scientific 21b
American Greetings 14d	Avnet 21b	Brinker International 14a	CMS Energy 24a	CSX 23b	eBay 18c	FleetBoston Financial 3a
American Home 12b	Avon Products 6d	Bristol-Myers Squibb 12b	CNA Financial 17b	Cummins 15c	Echostar Communications 20a	Fleetwood Entls. 14d
American Intl. Group 17b	AVX 9d	Broadcom 9d	CNF 23c	CVS 12a	Ecolab 6d	Fleming 10a



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ALPHABETICAL LIST OF COMPANIES

The number following each company name identifies the Scoreboard category under which it is listed

Flowers Foods 10b	Hunt (J.B.) 23d	LSI Logic 9d	North Fork Bancorp. 3a	Progressive 17b	Soletron 9d	U.S. Industries 5
Flowersave 15c	Huntington Bancshares 3b	Lubrizol 4	Northeast Utilities 24a	Protective Life 17b	Solutia 4	UAL 23a
Floor 21a		Lucent Technologies 22a	Northern Trust 3b	Provident Financial 3b	Sonic Automotive 21e	UGI 24b
FMC 15c		Lyondell Chemical 4	Northern Trust 3b	Provident Financial 3b	Sonoco Products 7b	Ultramar Diamond Shamrock 11
FMC Technologies 11b			Northrop Grumman 1	PS Co. of New Mexico 24a	Southern 24a	Union Pacific 23b
Foot Locker 8			Northwestern 24a	PSS World Medical 21b	Southern Union 24b	Union Planters 3c
Footstar 8			NRG Energy 24a	Public Service Ent. 24a	SouthTrust 3c	UnionBanCal 3d
Ford Motor 2a			NSTAR 22a	Puget Energy 24a	Southwest Airlines 23a	Unisys 18b
Ford Laboratories 12b			Pulte Homes 13b	Quantum Services 21a	Sovereign Bancorp 17c	United Parcel Service 23d
Fortune Brands 15a			Qualcomm 9b	Quantum DJT & Storage Sys. 18b	Spherion 21e	United Rentals 21e
Foster Wheeler 21a			Quantum Group 21d	Quest Diagnostics 12c	Spiegel 8	United Stationers 21b
Fox Entertainment 20a			ON Semiconductor 9d	Qwest 24b	Sports Authority 8	United Technologies 1
FPL Group 24a			Okeok 24b	Quintiles Transnational 21e	Sprint FON Group 22a	UnitedGlobalCom 20a
Franklin Resources 17a			Oracle 18c	Qwest Comms. 22b	Sprint PCS Group 22a	UnitedHealth Group 12c
Freddie Mac 17a			Oshkosh Truck 2a		SPX 9a	Unifon 17b
Freight-McCarran C&G 16c			Outback Steakhouse 14a		St. Paul 17b	Universal 6e
Frontier Oil 11a			Owens & Minor 12d		Staff Leasing 21e	Universal Forest Products 19
Furniture Brands 6b			Owens-Illinois 7a		StanCorp Financial Group 17b	Universal Health 12c
			Oxford Health Plans 12c		Standard Pacific 13b	Unocal 11a
G					Stanley Works 15b	Unum 15c
Gannett 20b					Staples 8	UnumProvident 17b
Gap 8					Starbucks 10b	URS 21a
Gateway 18b					Starwood Hotels & Resorts 14c	US Airways Group 23a
GATX 23c					Street 3a	US Oncology 21e
Genentech 12b					Steelcase 18a	USA Education 17a
General Cable 16c					Stilwell Financial 17a	USA Networks 20a
General Dynamics 1					Storage Technology 18b	USFreightways 23d
General Electric 5					Stryker 12d	USG 13a
General Mills 10b					Suiza Foods 10b	UST 6e
General Motors 2a					Sun Microsystems 18b	USX-Marathon 11a
Genesis Health 12c					SunCard Data Systems 18c	USX-U.S. Steel 16b
Geniva Health Svcs. 12a					Sunoco 11a	UtiliCorp United 24a
Genzyme General 12b					SunTrust Banks 3c	
Georgia Gulf 4					Superior TeleCom 16c	V
Georgia-Pacific Group 19a					Supervalu 10a	Valero Energy 11a
Gillette 6d					Swift Transportation 23d	Valspar 13a
Global Crossing 22a					Symbol Technologies 18b	Value City 8
Golden State Bancorp 17c					Synovus Financial 3c	Vectra 24b
Golden West 17c					Sysco 10a	Veritas Software 18c
Goldman Sachs Group 17a						Verizon Communications 22b
Goodrich 1						VF 6a
Goodyear Tire & Rubber 2c						Viacom 20a
Grace (W.R.) 4						Viad 5
Grainger (W.W.) 21b						Vishay Intertechnology 9d
Granite Construction 21a						Visteon 2b
Great A&P 10c						Vulcan Materials 13a
Great Lakes Chemical 4						
GreenPoint Financial 17c						W
Group 1 Automotive 21e						Wabash National 2b
Guild 12d						Wachovia 3c
						Walgreen 12a
H						Wal-Mart Stores 8
Halliburton 11b						Walter Industries 5
Harley-Davidson 14d						Washington Mutual 17c
Harman International 6b						Washington Post 20b
Harrah's Entertainment 14b						Waste Management 21c
Harris 9b						Watson 13a
Harsco 15a						Weatherford Intl. 11b
Hartford Financial Services 17b						WellPoint Health 12c
Hasbro 14d						Wells Fargo 3b
Hawaiian Electric 24a						Wendy's Intl. 14a
HCA 12c						WESCO International 21b
Health Management Assocs. 12c						Western Digital 18b
Health Net 12c						Western Gas Resources 24b
Healthsouth 12b						Western Resources 24a
Heinz (H.J.) 10b						WestPoint Stevens 15d
Hercules 4						Westvaco 7b
Hershey Foods 10b						Weyerhaeuser 19b
Hewlett-Packard 18b						Whirlpool 6b
Hibernia 3c						Whole Foods Market 10c
Hillenbrand 15a						Williams Industries 19b
Hilton Hotels 14c						Williams 24b
Hollinger International 20b						Williams-Sonoma 6b
Hollywood Ent. 14b						Winn-Dixie Stores 10c
Home Depot 8						Wisconsin Energy 24a
HON Industries 18a						WorldCom Group 22a
Honeywell Intl. 5						Worthington Inds. 16b
Hormel Foods 10b						WPS Resources 24a
Horton (D.R.) 13b						Wrigley (Wm.) Jr. 10b
Household Intl. 17a						X Y Z
Hub Group 23c						Xcel Energy 24a
Hubbell 9a						Xerox 18b
Hughes Electronics 9b						Xilinx 9d
Hughes Supply 13a						Yellow 23d
Humana 12c						York Intl. 13a
						Zale 8
						Zions Bancorporation 3d

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For the better part of the nation's history, the way west for Americans lay in Missouri. First it was through St. Louis, which began as a French trading post. It was from here that Lewis and Clark launched their historic expedition in 1804. In time the focus of westward migration moved to Kansas City, a jumping-off point for the Santa Fe and Oregon trails.

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ed Missouri its reputation as "Show-Me" state. They were practical, value-driven people. Here and there an adventurous spirit was thrown into the mix. Consider a few of the progeny given birth by Missouri: Harry S. Truman, Jesse James, Mark Twain, General John "Blackjack" Pershing, T.S. Eliot and, more recently, Calvin Trillin.

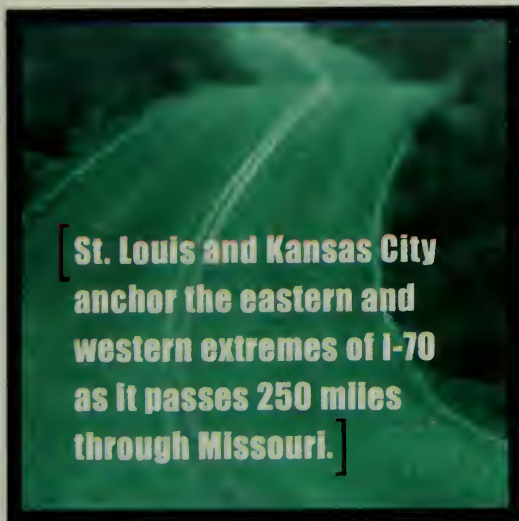
Admitted to the Union in 1821 as the 24th state, Missouri prospered. Its cities became hubs for travel, for railroads and for highways. Stockyards and packing plants flourished for miles. Land in every direction was turned over to the production of wheat, and Missouri

remained in the heart of America's breadbasket. Today the world's wheat prices are set each morning in the Kansas City Board of Trade.

The successive layers of enterprise have become the economic bedrock that is the strength of Missouri today. "We have many basic companies," says Michael Zuk, vice president, financial services in the Kansas City office of investment bank & Co., Inc., members of the New York Stock Exchange. "Many of our companies are 'blocking and tackling' companies, providing either products or services that are often integrated into other people's products. The virtue in that there is generally a constant market for what we manufacture or what we deliver."

Sticking to the basics has paid off. Today, with the most diversified economy in the nation, Mis-

souri has a gross state product of \$166.5 billion. Missouri's exports in 2000 exceeded \$8.4 billion in products and services to more than 180 countries. The state has 1,180 miles of interstate highway miles, two international airports, and two major rivers with 1,040 navigable water miles. It has the sixth-largest highway system in the nation, the second- and third-largest railroad terminals in the nation. And, with a population of 5,600,000, Missouri in the second quarter of 2001 had the third-lowest cost of living in the nation. In a way, the state prospered because people who went west found



St. Louis and Kansas City anchor the eastern and western extremes of I-70 as it passes 250 miles through Missouri.

that Missouri had everything they were looking for, and built upon it. Today, a great many businesses are coming to that very same conclusion.

Missouri's history of building upon its economic past can be seen as a prologue to its economic future. "We have," says Governor Bob Holden, "a highly skilled and productive workforce, a great quality of life and a pro-business climate that will foster the growth of the life sciences and other key industries in the 21st century."

In life sciences, one important area targeted by the state for future economic development is plant science. It is a field that has a place of special prominence and promise in St. Louis. Last November, teams of researchers began moving into the newly completed \$146 million Donald Danforth Plant Science Center in the St. Louis suburb of Creve Coeur. Built with the

help of nonprofit, academic and government contributions, the center is bringing together under one roof an array of researchers focused on plant research that can, by enhancing our understanding of agriculture, improve the human condition.

The center is named for the late Donald Danforth, former chairman of St. Louis-based Ralston-Purina Co. Danforth was the father of former U.S. Sen. John C. Danforth, R-Mo., and Dr. William H. Danforth, former chancellor of Washington University in St. Louis. The nonprofit, independent center adds to the growing reputation of the metro-

politan region as a focal point for plant and life sciences. St. Louis, in fact, is now mentioned as a major center of plant and life sciences, along with Raleigh-Durham, Seattle, Boston, and Washington, D.C. In fact, the 12-county metropolitan area, which sits astride the Mississippi River, is being touted as the "BioBelt," home to a cluster of 1,200 firms that are in the business of plant and life sciences.

The emergence of St. Louis as Missouri's BioBelt is mirrored on the western end of the state by Kansas City. Like its St. Louis counterpart, Kansas City is a river-front community that is gaining attention for its leading-edge

research facilities. Foremost among them is the \$200 million Stowers Institute for Medical Research, opened a little more than a year ago. It and other research facilities have led to talk of Kansas City as being a "Biomed Valley."

In point of fact, the two metropolitan areas anchor the eastern and western extremes of I-70 as it passes 250 miles through Missouri, leading to yet another sobriquet: "The Biotech Corridor." That's the term favored in the city of Columbia, home to the University of Missouri, where ground recently was broken for construction of a \$60 million Life Sciences Center.

The corridor represents a border-to-border economic silver lining for Missouri. Governor Bob Holden has made it clear that life sciences is one of the three clusters — along with advanced manufacturing and information technology — to be given special emphasis in the state. Missouri last summer set aside \$22 million of its \$374 million



Missouri's Governor Bob Holden

In Columbia, home to the University of Missouri, ground was recently broken for construction of a \$60 million Life Sciences Center.



tobacco settlement for life sciences funding, and plans for its use are now in the works.

With a sound economic foundation in place, Missouri is laying new economic groundwork from end-to-end. Its cities are renovating and rebuilding. Its corporate citizens are reinvesting in their communities. Its people are learning the new skills needed by tomorrow's workers. And there is, says Joe Driskill, director of Missouri's Department of Economic Development, a sense of purpose shared by the private and public sectors. "I do not know of a time when there has been a stronger sense of partnership about the opportunities for our future economic growth," says Driskill. "I think we have unanimity in that regard."

And everywhere one looks in Missouri, the partnerships and shared sense of purpose are paying dividends.

St. Louis: Building on the basics

One of many decisions that Aurora Foods Inc. had to make during the past few years was where to locate the company headquarters. The choices came down to three locations. For James T. Smith, the chairman and CEO who is leading the \$1 billion company in a turnaround, St. Louis was the best of the lot. Among the reasons cited by Smith: "We felt it would be a lot easier to attract new people as we were expanding the company."

Said by some to be the westernmost of Eastern cities, St. Louis has a cosmopolitan lifestyle that suits many young executives like it was made-to-order in the fitting room. There are riverboat excursions on the Mississippi, a symphony orchestra, an excellent art museum, a world-class zoo and enough other cultural attractions and sights to fill in weekends for a year or two. Then there are big league sports: the St. Louis Cardinals, the St. Louis Rams, and the St. Louis Blues. Moreover, of the top 20 metropolitan areas, St. Louis has the second-lowest cost of living. Suffice to say, 80 new people have joined Aurora Food's headquarters in St. Louis, bringing the total number of employees there to 265.

Seven years ago St. Louis went on an economic roll that hasn't yet



In downtown St. Louis, where the landmark arch symbolizes the city's role as the gateway to the West, there is a flurry of hotel construction.

stopped. The region, says Richard C.D. Fleming, president of the St. Louis Regional Chamber and Growth Association, had suffered job stagnation. "Trend lines indicated no near-term up tick in the situation." To turn things around, a major campaign was mounted by Fleming's organization and the Greater St. Louis Economic Development Council to add 100,000 net new jobs to the economy from year-end 1995 through 2000. The campaign called for capitalization of \$10 million, but \$12 million was raised. When all was said and done at the end of 2000, the city had actually netted 117,000 new jobs.

But neither St. Louis nor Fleming is resting on any laurels. Some \$15 million has been raised so that the St. Louis metropolitan area, home to 2.6 million people and the 18th largest market in the U.S., can continue working on job recruitment, expansion and the creation of the new economy. The city's traditional strengths, and a flurry of big-ticket enhancements to them, also send a clear message that St. Louis is open for business.

Downtown, where the landmark arch symbolizes this city's role as the gateway to the West, there's a flurry of hotel construction. By early 2003 downtown St. Louis will have 7,600 hotel rooms within a mile of the America's Center convention complex. Downtown will get another boost as a result of the St. Louis Cardinals recent-

ly having reached an understanding with the city, county and state regarding plans for a new baseball stadium well as Ballpark Village, a surrounding residential, office and retail area.

A catalyst for downtown development are incentives put in place by Missouri in the form of state income tax credits for 25 percent of rehabilitation costs of eligible historic structures. Another boost comes from a \$1.4 billion downtown revitalization plan, which calls for building 2,800 residential units in addition to major upgrades and major construction projects.

But it isn't only downtown that's in the throes of redevelopment. Lambert-St. Louis International Airport is undergoing a \$2.6 billion airport expansion. "The single most important engine for economic development in metropolitan city is aviation," says John W. Bachmann, managing principal at Edward Jones, the privately held securities firm. Bachmann, who is about to serve his third term as chairman of the St. Louis Regional Chamber and Growth Association, was instrumental in resolving airport issues that had stalled progress in the past.

Bachmann went to work for Edward Jones while still in college. In 1980, when the St. Louis-based securities firm had 304 offices, he was given responsibility for the management of the business. Since then, Edward Jones has grown to 7,500 offices.

Key to the strategy is the one-brok-

*Mark Twain considered
intellectual work to be a pleasure.*



Obviously, he was a Missourian.



Intellectual 'work' is misnamed: it is a pleasure, a dissipation,
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office pioneered by Edward Jones, which increased revenues from \$16 million in 1977 to more than \$2.2 billion at year-end 2000. Today, Edward Jones has more branch offices than any other brokerage firm in the country.

Another of the area's great resources is its academic community, which includes a dozen colleges and universities as well as a number of two-year and community colleges. Among these is Washington University — officially Washington University in St. Louis — a world leader in teaching and research. The university is one of three institutions in the U.S. that worked on the human genome project.

Sitting shoulder-to-shoulder with leading-edge institutions such as Washington University in St. Louis are companies that quietly go about making our lives easier. A case in point is Peabody Energy, the world's largest coal company. America, Peabody likes to point out, finds the fuel for more than half of its electricity in old king coal. In fact, according to Peabody Energy, coal fuels more electricity than all other sources combined.

Peabody Energy should know. It is number one in sales, with volume 60 percent greater than its nearest competitor. For the year ending March 2001, Peabody sold 182 million tons of U.S. coal.

Coal is an abundant fuel, and represents more than 85 percent of America's fossil fuel resources — approximately six times all U.S. gas and oil reserves combined. It is mined in 26 states.

Peabody Energy holds the premier position in low sulfur, U.S. and world coal sales. It sells its products and services to 280 power plants and industrial facilities in the U.S. and 10 other countries.

The many and varied assets and resources seen as underlying strengths of the St. Louis area are evident even to those who are not familiar with the region. When Richard Fleming first came from Denver in 1994 to interview for the job at the St. Louis Regional Chamber and Growth Association, he knew little about the region. But after an extensive interviewing session and introduction to St. Louis, Fleming says he called his wife and told her, "I must say,

this city is really a very special place. He's since learned how right he was.

Kansas City looks ahead

Discoveries await newcomers every turn in Kansas City. Consider, for example, that this city astride the Missouri and Kansas rivers has more miles of boulevards than Paris and more fountains than any other city but Rome. As for a business presence, internationally known companies such as Sprint, Hallmark Cards, Marion Mirell Dow, Farmland Foods and H&



Football season brings fans out to cheer for the NFL's Kansas City Chiefs.

Block are headquartered here.

With a population of 1.8 million in the bi-state metropolitan area of 15 counties, Kansas City is the nation's second-largest rail center. It's also a trading hub. Kansas City International Airport is the number one cargo airport in the six-state region. At that, it is undergoing an expansion. Three major interstate highway systems make for easy access. Thanks to the Missouri River, Kansas City also has access to the Gulf of Mexico.

The Kansas City Board of Trade, established 150 years ago, is now the world's second-largest grain exchange. Moreover, with more than 1,500 miles of fiber optics installed beneath its streets, Kansas City is "wired."

There is a rich tradition of corporate success in the region. UtiliCorp United with \$29 billion in sales in 2000, is a noteworthy example. The company has its headquarters in a newly restored Italianate 19th century building on West Ninth Street in downtown Kansas City. UtiliCorp United was formed in 1985 from Missouri utility roots, and has expanded steadily by acquiring or sta-

regulated and nonregulated businesses in the U.S. and all overseas countries. UtiliCorp United positioned itself not as an integrated system, but instead developed distinct segments: generation, transmission, construction, maintenance — that comprise a chain. The company manages these various links to increase their value. "What we do,"

Ethan Hirsh, vice president, corporate communications, "is get part of the / back and reinvest it elsewhere." Today the company employs 8,000 people worldwide. Richard C. Green, chairman and CEO, while Robert K. Green is the company's president.

One of UtiliCorp United's premier positions was its Aquila division, which had \$26 billion in sales in 2000, as well as \$8 billion in assets. Aquila increased the size of its power generation portfolio while developing a



World headquarters for UtiliCorp United is in this restored landmark building in Kansas City.

steadily growing family of custom-designed risk-management products. These products might cover the risks of power outages or even weather futures.

In December of 2000 UtiliCorp United announced plans to complete an initial public offering of 20 percent of its Aquila subsidiary. But

as 2001 came to a close, UtiliCorp United announced that it planned to make an exchange offer by which it would acquire all of the outstanding publicly held common shares of Aquila, Inc. "We decided," said Richard C. Green, Jr., "that UtiliCorp shareholders would be better served by embracing the Aquila energy merchant strategy as the company's core strategy rather than spinning off as a separate entity." When the exchange is complete, Green said, "Aquila" will be adopted as the corporate name.

But there are also plenty of opportu-

nities for small businesses to flourish in the region. The late Ewing Kauffman founded Marion Laboratories Inc. in 1950, operating out of his own home in Kansas City. The Ewing Marion Kauffman Foundation, with assets of more than \$2 billion, is now located in Kauffman Legacy Park, which opened in 1999. The Kauffman legacy supports youth development and entrepreneurship programs.

Lifestyle also matters greatly in Kansas City, which counts among its cultural and artistic blessings the Nelson-Atkins Museum of Art, an outstanding assembly of Henry Moore sculptures, and the Kansas City Symphony. A favorite neighborhood for area singles is that surrounding Country Club Plaza, where upscale shopping and fine restaurants compare favorably with the best anywhere. Professional sports fans can root for the Kansas City Chiefs during football season and the Kansas City Royals during baseball season.

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Positioned for the future

St. Louis and Kansas City are both moving front and center in plant and life sciences. Many of the largest agricultural-related companies in the world have a presence in St. Louis, including Anheuser-Busch, Monsanto, Mallinckrodt and Ralston-Purina. In a study commissioned by the St. Louis Regional Chamber and Growth Association, these and other factors led the Ohio-based Battelle Memorial Institute to identify the region as a prime center for plant science and a major center for life science. With that, says Richard C.D. Fleming, president and chief executive officer of the SLRCGA, there came another conclusion: "St. Louis is positioned to be the world leader in plant sciences." The association soon began branding the area's plant- and life-sciences cluster as the "BioBelt."

The director of the Danforth Center in Creve Couer is Roger N. Beachy, a former instructor at Washington University who holds a Ph.D. in plant pathology from Michigan State University. Until now, says Beachy, plant science has been a "poor cousin" of life sciences, garnering minimal government research awards and relatively modest corporate contracts. The director, who is in the process of hiring 225 researchers to staff the center, hopes to close the gap. And doing so could have vast implications for the future.

In the last 50 years the world population has increased from 2.5 billion to 6 billion people. During that same time the earth has lost 25 percent of its topsoil, 20 percent of its agricultural land and one-third of its forests. In the face of these diminishing resources, plant research is the key to unlocking the secrets of genetic resistance, chemical controls and other mysteries that will result in higher crop yields.

At the other end of the Biotech Corridor, in the 15-county Kansas City metropolitan area, an estimated 250,000 jobs were created in the last

10 years. Now, the region stands to benefit from the creation of a life science economy.

A moving force in that direction is the not-for-profit Kansas City Area Life Sciences Institute, Inc., launched in 1999 by civic, business and research leaders. Among the life science research organizations collaborating in the KCALSI efforts, the Stowers Institute for Medical Research is among the newest and most notable. American Century Cos. Inc. founder James Stowers and his wife, Virginia, announced in 1994 that they would devote their personal fortune to medical research. The result was the opening in November 2000 of the \$200 million Stowers Institute, as well as an early gift from the namesakes of \$1.1 billion in securities. Eventually, some 600 scientists will be doing research at the institute.

The KCALSI and other biomedical research proponents often refer to "islands of excellence" within their

center, a range of life sciences programs will be integrated. "It's a facility," he says, "designed to promote scientific interactions."

Yet another connection in the Biotech Corridor is being fused by the University of Missouri-Rolla and Fort Leonard Wood, which are within 30 miles of each other. The Rolla campus is one of four maintained by the University of Missouri, and is its primary technological facility. Fort Leonard Wood is a center for the U.S. Army's environmental technologies, including its biological, chemical and nuclear schools.

Still other developments promise to enhance the research capabilities along the length of the Biotech Corridor. In St. Louis, Sigma-Aldrich Corporation hurried in recent weeks to complete its \$55 million Life Science Technology Center. In spring of 2001, Washington University began construction of a \$30 million medical engineering building. The Missouri Botanical Garden is ho-

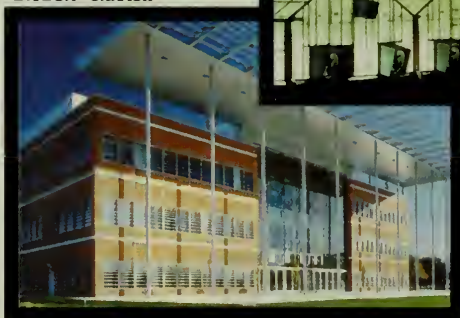
to the world's most active research program in tropical botany, and the site of a \$200 million Monsanto Center that holds millions of plant species. And Monsanto Company operates the Chesterfield Village Research Center, home to more than 900 scientists dedicated to biotechnology. Still another St.

Louis asset is the Nidus Center for Scientific Enterprise, a business incubator focused on life sciences.

On the Kansas City side of the research ledger, Quintiles Transnational Corp., which purchased Hoechst Marion Roussel's drug development labs in Kansas City, helped set up the Missouri Biotechnology Association. The organization grew from 20 to 125 members within a year.

Its formation is just one more example of how I-70, Missouri's Biotech Corridor, has put this state on the fast track to the future. ☺

Greenhouses at Monsanto's Research Center (right) and the Donald Danforth Plant Science Center are part of the St. Louis region's "BioBelt" cluster.



midst. While the Stowers Institute is the biggest research island in the chain, there are others. These include the University of Kansas Medical Center Research Institute; the University of Missouri at Kansas City; and the Midwest Research Institute, a provider of contract research and development services in biomedicine and pharmaceuticals.

An equidistant 125 miles from Kansas City and St. Louis is the city of Columbia, a kind of linchpin for the I-70 Biotech Corridor. Here the University of Missouri recently broke ground for its \$60 million Life Sciences Center, scheduled for completion in 2004. With this facility, says Dr. Michael Chippendale, interim director of the

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- Long-term growth from new energy businesses, including development of mine-mouth coal-fueled generating plants like the Thoroughbred Energy Campus in Kentucky and the Prairie State Energy Campus southeast of St. Louis. Prairie State would provide ultra-low-cost power for Missouri and other states while setting the environmental standard for coal-fueled generating plants.
- A strong earnings profile and financial flexibility. Peabody has rapidly deleveraged, improving its debt-to-total-capital ratio to 47%. And the company faces greatly improved earnings visibility by entering into long-term coal contracts at improved prices for 2002 and beyond.
- Proven management aligned with shareholders. Peabody is led by industry and company veteran Irl F. Engelhardt, chairman and chief executive officer. Under Engelhardt's guidance, Peabody has enjoyed an unparalleled record of growth since 1990, while setting new records for safety and environmental excellence.

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NOT GETTING ANY HELP FROM YOUR EX?



ODDI GUTNER

businessweek.com

Qualified Domestic Relations Order, or QDRO, can be used to collect overdue child-support payments from retirement accounts

It had been 10 years since her ex-husband had last made a court-mandated child-support payment for their four children. After numerous judicial procedures failed to collect the \$160,000 he owed her, this woman tried a little-known but powerful legal alternative that worked. She used a Qualified Domestic Relations Order (QDRO) to tap her former husband's 401(k) plan.

QDROs are obscure legal documents commonly used to help a former spouse get his or her fair share of a retirement account accumulated during the marriage (BW—July 16). However, “very few of the nation’s attorneys know that a QDRO can also be used to access retirement accounts to pay child-support arrearages,” says Tim Voit, president of Voit Econometrics Group, an economics consultant in Naples, Fla.

That’s unfortunate, since about half of all annual child support goes unpaid. Only \$13 billion, or 56%, of the \$23 billion due was collected for fiscal year 2000, according to the National Child Support Enforcement Assn. in Washington, D.C. In such cases, it’s typically the wife who suffers.

To obtain a child-support QDRO, your attorney or state child-support agency must first determine what kind of retirement benefits your ex-spouse is entitled to from current and former employers. Once you have identified the 401(k) or pension plans, contact the plan administrators to request copies of their written QDRO procedures. You also should ask for information on the amount due to your ex and the earliest date funds may be withdrawn from the plan. The federal Employee Retirement Income Security Act requires plans to provide all this information as soon as they are notified that a child-support action has begun. Next, call your state child-support agency to obtain a detailed list of delinquent payments as of a specific date.

Using all of this information, have an attorney who specializes in QDROs draft the order, then submit it to the divorce court and the plan administrator for approval. Finally, says Voit, “be sure you send the final, court-approved

QDRO to the plan, or else you won’t get paid.”

Usually, it takes about three months for payments to begin. “They will continue uninterrupted even if the noncustodial parent changes jobs, becomes unemployed or disabled, runs away, or even dies,” says David Clayton Carrad, a lawyer and president of QDRO Solutions, an Augusta (Ga.) consultant to state child-support enforcement agencies. The money will be taxed at the capital-gains rate of 20%, but often the plan participant will be required to pay rather than the recipient.

Using a QDRO to secure child support has many advantages. Most important, you can get access to the money long before your delinquent ex-spouse retires. In many cases, “pension plans provide early-payment options, which means that

they may be tapped for child support immediately,” says

Carrad, “whether the participant retires or continues to work.” A QDRO also gets funds at their source, unlike other legal remedies that encourage child-support payments via threats of

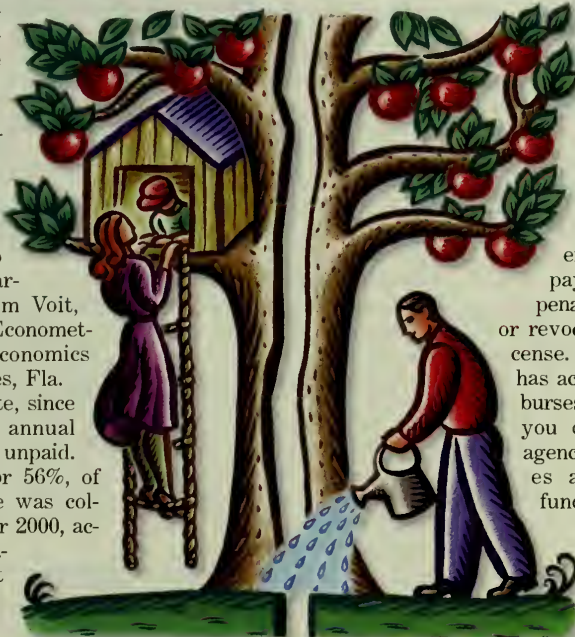
penalties, such as jail time or revocation of a driver’s license. Once a pension plan has accepted a QDRO, it disburses payments directly to you or the child-support agency. Your ex-spouse loses all control over the funds. You can obtain a

QDRO against retirement-benefit plans anywhere in the country, and the order can be modified to increase or

decrease payments if the child-support arrearages have risen or been paid.

QDROs, which cost about \$500 to make up, do have drawbacks. Since every pension plan is different, each QDRO must be custom-tailored to meet the plan’s requirements. QDROs are also more complicated and difficult to draft than other child-support enforcement remedies, such as wage attachments. Finally, a QDRO only covers private employers’ retirement plans. You must follow separate procedures to collect child support from individual retirement accounts or from government or military plans.

Retirement accounts are the foundation of an average household’s wealth. So, if you have a former spouse who is shirking child support obligations, it pays to go after this source of funds. ■



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DOOZIE

THE BONEHEAD BARKER REPORT



BY ROBERT BARKER
rb@businessweek.com

So Krispy Kreme was tasty after all. Delphi sputtered. And Coach looks handsome. Hey, a columnist can't get it right every time

The new year will be here in no time, and I'm curious to see what fresh financial mayhem it brings. Before that, though, it's only right to look over my shoulder to see what mayhem The Barker Portfolio has caused. To that end, I searched the archive for columns that by December were at least a year old and had been proved by time and events to be plainly wrong. With my regrets, here are the doozies:

■ **Delphi Automotive Systems.** One day, this spun-off General Motors parts maker will be a terrific stock. It has proved to be just the opposite since I pointed out its potential at \$20 a share in June, 1999, (charts) and compounded the error a year later when I favored it over Visteon, Ford Motor's spun-off parts maker. Visteon shares now idle near \$14, about where they started; at \$13, Delphi's seem to be stuck in reverse.

Delphi has progressed on many fronts, notably by reducing its dependence on sales to former parent GM, which dropped to 68% of total revenue in 2001, from 78% in 1998. Its electronics have even made their way into the hyper-hyped Segway scooter. Yet Wall Street is impatient with Delphi's inability to generate much in the way of cash flow that is free of costs from a restructuring that seems only to go on and on.

■ **Coach.** Before this maker of classy leather goods and fashion accessories went public in October, 2000, I was deeply skeptical. "Coach is fully priced," I warned. "Bargain hunters must wait." Boy, was that wrong. Coach sold its first shares at \$16, and that has proved to be the low. Coach peaked at \$42.75 and has been trading lately near \$35.

Coach has handily managed the two challenges—profit growth and debt service—that I focused on. First, despite sharp competition, it boosted sales by 12% and profits by 66% in the fiscal year ended June 30. Margins widened dramatically as Coach added new product lines and sold more abroad, particularly in Japan. Cash flow in the fis-

cal year surged 46%, which enabled Coach pay off much of its debt while opening stores and remodeling old ones. Even in weak economy, CEO Lew Frankfort sees no reason why Coach won't keep growing its number of stores and profits. "Holiday season sales strong," he told me. "Investors will be pleased."

■ **Rockland Small Cap Growth.** In the fall of 2000, after years of laggardly performance, small stocks were outpacing large caps. I figured momentum would continue at least through 2001. On that much, I was right. Yet I misjudged risk in one of the two small-cap mutual funds I pointed readers toward. Rockland Small Cap Growth Fund lost 39% in the 14 months ended Nov. 30, while the average comparable fund lost 27%.

Manager Dick Gould trades his portfolio furiously, a strategy that worked great in the fund's first four years. In the past year, it seemed only hurt. Gould said he was fooled by market bounces. The bearish trend led to "an awful lot of fake [upside] breakouts," he told me. "It's easy to be whipped around if you're not careful, and I think we got whipped around."

■ **Krispy Kreme Doughnuts.** "Anybody paying \$20.75 a share [adjusted for splits] is a stake in Krispy Kreme will have an insanity plea based on the Twinkie defection to rely on after plunges," I wrote in October, 2000. Oh, those words make me queasy today. By Ju-

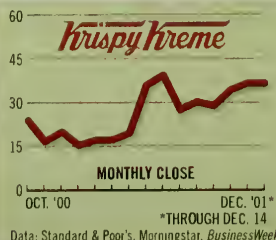
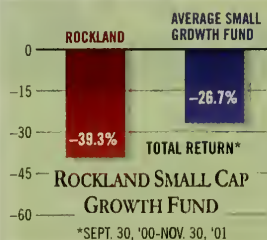
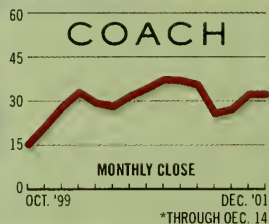
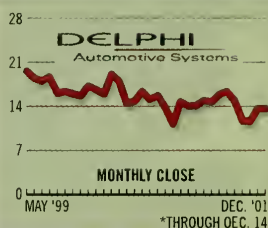
ly, the stock had split twice, doubling in value. It's still near \$40, up 92% since my column.

My mistakes? I did not count on company beating analysts' earnings estimates by a penny each quarter as it kept expanding (latest outpost: Canada). I underestimated investors' steady devotion to a stock that trades at multiples above rate of earnings growth. Krispy Kreme shares command 65 times the Street's estimate of profit in the fiscal year ending Jan-

uary, 2003. Meantime, Wall Street sees profit growth just 38%. Go figure, I might say, but the figures would show only that I was wrong on the stock.

Now that I've had my serving of crow for the year, I'm ready for a dessert of humble pie. No, wait—better yet, a Twinkie.

Four Wrong Turns



Data: Standard & Poor's, Morningstar, BusinessWeek

BusinessWeek online

For barker.online, go to
www.businessweek.com/investor/ and click on "Columnist"

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2002

Retirement, Rollovers, Risk and Reality

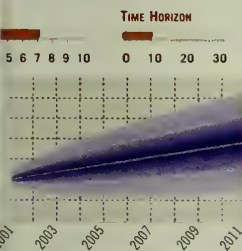
Monte Carlo Analysis
Test your Portfolio
Your financial or retirement plan project the market returns of 2000-2001? Is your portfolio's current valuation near where it is projected to be? You ever "audit" your financial plan stress test" how close it is to market reality?

I answered "no" to any of these questions—you are leaving your financial future to

chance. Unfortunately, most financial and retirement plans use "average" results in calculations, usually assuming portfolio returns will be the same every

year. Such plans also project tax inflation, your spending needs and income on a

Monte Carlo Analysis



As the Time Horizon, you have the growing probability to meet or exceed the stated wealth figure:

Probability	Wealth
10%	\$4,385,064
50%	\$2,345,148
90%	\$1,254,194

on a line basis. We all know the markets and life simply do not conform that way. There are ups and downs in each of these years of your financial life. A good is a plan that ignores reality?

The purpose of a financial plan is to plot a course for your financial future. A well-designed plan should serve as a map and accurately show you that there will be peaks and valleys along the way.



For 18 years the focus at Hartwell Financial Services has been on the high net worth family that is looking for a personalized approach to the financial planning process. The firm coordinates the Asset Allocation, Financial, Tax and Estate Planning process for clients. The ultimate goal is to provide an integrated structure for passing important values on to future generations. For more information about this innovative, realistic approach to building intelligent investment strategies, contact Philip Hartwell.

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In the face of declining markets, unanticipated layoffs, early retirement or retirement taken in better times, it is more important than ever to understand these critical risks to your financial future. Today's savvy investors are stress testing their portfolios' likelihood of success with Monte Carlo Analysis.

Monte Carlo Analysis, a form of probability testing, was first used by the Manhattan project during WW II. Today's high-speed computers enable us to use this sophisticated tool, running thousands of scenarios on an investment portfolio and financial plan to predict the probability of success.

This changes the question from "How much risk are you willing to take?" to "How little risk is necessary to achieve your retirement goals?"

Market-Neutral: Conservative Strategy in Volatile Times

Hedge funds continue to be one of the most misunderstood areas of finance, often perceived as having greater volatility and risk than other strategies. This is due to an over-publicized hedged strategy called Global Macro, which experienced large declines in the 1990s after a decade of exceptional performance. That strategy placed large directional bets and used significant leverage, however, less than 5% of hedge funds utilize those investment strategies.

Institutions concerned about return consistency have traditionally employed hedging strategies, but today hedge funds comprise one of the fastest growing sectors of investing for sophisticated individuals as well. The typical hedge fund attempts to reduce volatility and risk, while preserving capital and delivering positive returns in most advancing and declining markets.

The Market-Neutral strategy, first developed in 1973 by a leading investment firm (see profile box), is an even more conservative type of hedged strategy, uncorrelated to equity markets and designed to deliver consistent, steady returns over the long-term with low risk. These strategies seek returns of 90-day Treasury Bills plus 3-5%. They are designed to eliminate systematic (market) risk by taking offsetting long and short equity or bond positions within the same portfolio.

Market-Neutral strategies are popularly used in lieu of bonds, or as a portfolio diversifier for sophisticated investors. Managers typically use quantitative investment techniques to

identify attractive long and short candidates for a portfolio. More rare is the manager who uses both quantitative and fundamental analysis for stock selection.

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Investment Management Inc.

SSI Investment Management, a Los Angeles-based registered investment advisor, manages \$700 million USD in assets. In 1973, SSI became the first firm to introduce Market-Neutral hedging to investors and apply a computer-driven model to stock selection. By combining a proprietary quantitative process with fundamental analysis, SSI has produced the longest, consistent track record in the field of Market-Neutral investing.

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Long/Short Equity Market-Neutral strategies employ equities both long and short. The strategy is widely diversified, has equal dollars long and short, and is controlled for industry, sector, market capitalization and other exposures.

Hedged Convertible Market-Neutral strategies take advantage of the high interest income available on convertible bonds and convertible preferreds, hedging the equity risk with a short position in the same company's underlying common stock.

By blending the above two Market-Neutral strategies within one portfolio, investors benefit from diversification and additional reduced volatility.

Where do you go to seek consistent, double-digit annual returns in the future? With the stock market becoming more volatile, it is time to consider conservative hedging strategies that are designed to protect capital while reaping strong returns.

Lessons from a Challenging Year in the Market

It will come as no surprise to investors that the past year has been a challenge. Following nearly a decade of outstanding performance where the market entered a period of consolidation and retreat. Everyone suspected that such a day was coming, however no one knew when that day would come. That mystery has been resolved giving rise to the next unknown: *how long the bear market will really stay with us.*

What is there to be learned from the last 18 months? Perhaps the oldest lesson is the most important: **diversification still matters.** At its most basic, maintaining a diversified portfolio is simply a way of acknowledging that economies and markets change, creating opportunities for different styles of investing.

The second lesson is that it is still early in the game. Viewed on a macro level, we are in the midst of a process of market democratization that goes back at least to 1975, when stock trading commissions were deregulated. This gave rise to the discount brokers, which helped usher in a new group of self-directed investors to the market. Today, more than 50% of American households now own mutual funds, up from just 5.7% in 1980 (*Investment Company Institute Fundamentals Report, Sept. 2001*).

Thanks to the explosion in financial media, individuals can watch investments more closely than ever. Market news, which used to be limited to a few professionals, is now inescapable.

That brings us to the third lesson: **democracy is hard work.** By extension, a democratized

investment market—one in which information and a range of investment options are both freely available—requires that investors do their homework. To be comfortable with the risk that accompanies the choices they have made—especially in more challenging market environments—individuals need to better understand what they are buying. Knowledge tends to crowd out emotion in the decision making process.



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Investors have remained calm throughout a tough market. The pressure is building to “do something.” For those who have focused portfolios too narrowly, reallocating some assets may be wise. For others, re-reading the prospectus might be enough to restore confidence in why they invested in the first place.

“History is bunk,” said Henry Ford, and when the “new economy” was in full dot-com powered swing, it was convenient to forget the lessons of the past. Unfortunately, history has a way of reasserting itself, often at the most inconvenient times.

Change happens—for the better and sometimes not. Recognizing this, and preparing for it, is the best lesson of all.

Growth Investing – A Contrarian Strategy

After being the best performing investment style through the last half of the 1990s, the growth style of investing has fallen on hard times. The extreme outperformance of value the past two years makes growth the contrarian investment style.

Diversification is the cornerstone of sound investment management. The benefit of reducing risk by combining uncorrelated assets has been well proven in financial literature. If that is the case, why is it so hard to accomplish on a consistent basis? It is often recognized that fear and greed are the driving forces in the stock market. Unfortunately, these emotions blind us to reality. Greed blinds us to danger while fear blinds us to new opportunities.

This occurs when logic loses out to emotion. It is one of the primary reasons why it is so hard for investors to buy low and sell high.

amplified. In 1998 and growth outperformed value 23% and 16% respectively. In 2000, value outperformed growth by 29%. This past year we have seen the widest gap in history as value has outperformed growth at it widest margin by over 40%.



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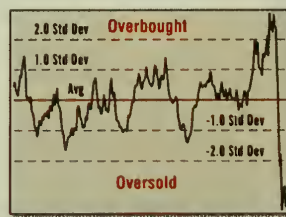
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As we look at the current market it is quite easy for investors to ask the question, “Is growth dead?” How can investors take advantage of the extremes we

are seeing in the current market? While the answer may be relatively simple, the execution is often difficult. Investors need to eliminate emotional decisions and base their actions on long term time horizons and disciplined investment strategies. The long-term goal of being properly balanced between growth and value would have investors to reduce growth and add value in 1998 and

and reverse those actions. To be truly successful in the current run, investors must be disciplined and rational in their analysis and challenge the assumptions that prevent us from buying low and selling high.

GROWTH EXTREMELY OVERSOLD
RUSSELL 1000 GROWTH TOTAL RETURN INDEX (Y/Y) MINUS
RUSSELL 1000 VALUE TOTAL RETURN INDEX (Y/Y)-MONTHLY



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Nowhere is this phenomenon better illustrated than in the analysis of growth and value styles of investing. Over the last 20 years, the normal spread between growth and value returns has been 10%. In the last four years, returns have been

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2002

Keep the Tax-Man Away from Your Legacy!

year, in a startling move simplicity, the IRS issued id generous regulations ing retirement account ince Your retirement ist became more fruitful, you taking the proper ensure that they bloom tely?

most exciting change is the proval of the "Inherited This change allows the ed tax-deferred growth of d retirement assets (such

, 401Ks, 403Bs, tc.) over the life- your children, children, and great-grandchild-

The difference an IRA distrib- ntirely to heirs the year follow- ir death, versus which allows ed tax-deferral ceeding genera- s monumental. unately, the y of inherited and are fully o the heirs with- to five years,

leads to rapid and ating erosion of your hard- legacy.

example, adding your ent account to your child's income in a single year push most taxpayers into p tax bracket of 39.6%. 7% state income tax and \$100,000 IRA just dwin- \$53,400. Finally, if estate are removed, the total at taken away from your ould exceed 70% of your On the other hand, if set up ly, your \$100,000 IRA, left 0 year old heir, could dis- up to \$1,329,456 (assum- 0% rate of return) over their ectancy!

ow do you keep the Tax-Man rom your legacy?

First and foremost, you must make sure the custodian of your retirement fund allows inherited IRAs. Most employers have not changed their retirement plans to include the new rules and probably won't, because of the inherent liability of perpetual custodial fees. Many of the national investment companies have not updated their custodial agreement to allow for the inherited IRA because they simply are not aware of the intricacies involved.



The Householder Group is the nation's largest independent retirement and estate planning firm with SunAmerica Securities, Inc. As a Registered Investment Advisory firm, The Householder Group specializes in developing and implementing retirement and estate plans for private clients. The firm incorporates advanced tax planning techniques to minimize income and estate taxes, and they utilize conservative asset allocation models in order to focus on capital preservation and multi-generational wealth management.

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Second, you must name a beneficiary. Naming a qualified trust as your beneficiary allows you to distribute your assets with maximum control even after you die. Furthermore, a qualified trust can protect your legacy from your child's creditors, divorce, or even frivolous spending habits.

The IRS has given you the opportunity to protect your hard-earned legacy, but without proper planning that opportunity will wilt on the vine. To avoid the potential pitfalls of the new tax laws it is critical that you consult with an estate and retirement specialist, one familiar with the additional protections provided by a qualified trust.

Controlling Risk with Balanced Portfolios

Are bonds only appropriate for grandmothers? That is the common perception among individual investors due to the strong returns from stock investments during the late 1990's. The most recent bear market for stocks has helped change that belief structure as people witnessed their stock savings dwindle with the falling stock indices, such as the Nasdaq 100.

Because of their low correlation with stocks and lower price volatility, bonds improve the risk-reward trade-off of a portfolio over the long term, say ten plus years. In 2001 as the U.S. stock markets headed south, falling short and long-term interest rates propelled bond valuations to new heights. Investors who included investment grade bonds with stocks in their portfolio were pleased by their portfolios' out-performance as well as the steady income return and lowered risk.

A diversified bond portfolio serves as a sophisticated portfolio management tool to hedge against risk. The Dow Jones Industrial Average has suffered declines as much as 30% to 50%, such as when it fell 53% in 1931. The benefit of adding just a twenty percent bond position to a stock portfolio and other assets can significantly reduce the downside of the overall portfolio's return without limiting too much of the upside. Laddering bond portfolios also allows investors to match maturities of their bonds with a series of scheduled liability payments

such as annual tuition requirements or IRA withdrawals.

The type of bond portfolio depends on the investors' risk tolerance, time horizon, and tax bracket. One of the benefits of municipal bonds is their double tax-free status that becomes more valuable the higher the individual's tax bracket. Small investors can invest in a diversi-

Rayner Associates, founded in 1977, is an investment advisory firm specializing in the custom design and management of individual and institutional investment accounts. Based in Mill Valley, California, the firm's expertise is in building well diversified equity portfolios seeking maximum long term total return, as well as balanced and bond portfolios that meet the specific needs of their clients. Minimum investment for an individual account is \$500,000. Rayner Associates also manages the Fremont California Intermediate tax-free fund, (FCATX), which has a minimum investment of \$2,000.

Mill Valley, CA 415-332-7433
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fied municipal bond portfolio by owning shares in a municipal bond mutual fund, which is a collection of bonds backed by the local economies of their state. Investors have the added psychological benefit of feeling they're supporting their local economies by investing in the bonds backed by their school districts, water utilities, etc.

*"One of the
benefits of
municipal bonds
is their double
tax-free
status..."*

So, for younger investors with a long time horizon, a balanced portfolio helps them to weather some of the volatile storms in the economy, increase after-tax income, preserve their nest egg, and sleep better at night! Investors at any age should welcome such benefits.

Deductions, Deductions, and More Deductions: A New ERISA

On June 7, 2001 President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). A sampling of the key provisions of this new law are as follows:

Profit Sharing Plans

The individual allocation limits will be increased up to the lesser of \$40,000 or 100% of the participants' eligible compensation, whichever is less, but with an overall deductible limit of 25% of the plan sponsors total eligible compensation. With these new and higher limits, Money Purchase Plans will become a relic of the past.

Defined Benefit Plans New Limits:

Age	Min. Required Salary	Maximum Contribution
30	\$25,000	\$75,000
35	\$25,000	\$95,000
40	\$35,000	\$125,000
45	\$45,000	\$160,000
50	\$60,000	\$200,000
57	\$70,000	\$220,000
62	\$80,000	\$235,000
65	\$90,000	\$275,000

Existing plans may have lower contribution levels due to the current value of the assets already in the plan. An existing Defined Benefit Plan, with a 55-year-old employee and \$750,000 in the plan, would be able to support a contribution of up to \$165,000 per year for seven years. These contribution amounts do not require insurance products of any kind, nor do they include 401(k) features. If a spouse is included, contribution levels could double.

401(k) Plans

The new limit will be the lesser of \$11,000 or 100% of eligible compensation, which increases by \$1,000 per year, going up to \$15,000 by 2006.

Catch up contributions for those who reach age 50 by the end of the plan year can be up to \$1,000 in 2002, increasing

ACTUARIES *Unlimited, Inc.*

For over thirty years, Actuaries Unlimited, Inc. has provided actuarial consulting services to all kinds and sizes of qualified retirement plans, without selling insurance products or investments of any kind. The company specializes in achieving maximum deductible contributions via Defined Benefit Pension or Cross Tested Profit Sharing Plans. All of these plans receive IRS approval and every report and 5500 series tax reporting forms are reviewed by an Enrolled Actuary before delivery to a client. The company presently has two offices, one in Los Angeles and one in Las Vegas:

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by \$1,000 per year thereafter, going up to \$5,000 by 2006. In this manner, those age 50 and older will be able to make total 401(k) contributions of \$12,000 in 2002, increasing by \$2,000 per year thereafter, reaching \$20,000 by 2006.

Loans

Participant loans will be permitted to all owner-employees regardless of the type of plan sponsor.

Compensation

This amount is increased to \$200,000. This means that future contributions and or benefit formulas can be reduced without decreasing benefits or contributions for the highly paid.

Conclusion

Most of these provisions are effective January 1, 2002. New Defined Benefit Plans, and Defined Contribution Plans that are converted into Defined Benefit Plans, with plan years commencing February 1, 2001 or later, can take advantage of the new Defined Benefit Plan limits in the year 2001.

Can Growth Stocks Rebound in 2002? Absolutely

If you were an investor who had most of your money in high growth technology stocks in the first quarter of 2000, you were not alone.

Analysts, company managers, investment professionals and the media were ebullient on the prospects for the economy, the stock market and technology stocks. We know what has happened in the ensuing eighteen months.

Consider the current investment environment: the U.S. economy is in recession, analysts are skeptical of future earnings prospects, the news is bleak and investor confidence is clearly negative. There is \$2.3 trillion in money market instruments (23.8% of the market value of the Wilshire 5000 Index) demonstrating extreme

caution on the part of investors and representing a tremendous amount of buying power.

The current situation is the flip side of March 2000. Today's environment presents as good a buying opportunity as the first quarter of 2000 presented a selling opportunity.

Buying stocks of high growth companies can be very rewarding over long periods of time. If you invested in a company that had earnings growth of 30% for 5 years, the EPS of that company multiplies 3.71x. If the price earnings ratio stays the same throughout the 5-year period, your stock is worth 3.71x your purchase price. Most likely, a growth company won't maintain a steady rate of growth and

the price earnings ratio will remain constant. However, if you were to make changes in your portfolio (buying companies with accelerating earnings growth and selling companies with decelerating EPS growth), you can maintain very high rates of return.

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Successful investing in growth stocks requires the investor to only focus on the long term but also to react to extreme capital market expectations. Extremes in expectation are identifiable relative to the price of the market as well as the predominance of positive or negative sentiment. Consider

"Today's environment presents as good a buying opportunity as the first quarter of 2000 presented a selling opportunity."

courage is required to act contrary to one's emotions.

Successful growth investing requires buying growth stocks at reasonable prices, and, just as important, selling these stocks when their earnings momentum is lost when capital market expectations are too high.

INVESTMENT & FINANCIAL PLANNING INSIGHTS FOR THE YEAR 2002

Option Hedging Strategies for 2002 and Beyond

devastation wreaked by equity market in 2001 has restored seeking alternatives institutional equity and income investment. With uncertainty surrounding equity prices and interest rates near all time highs, prospects are limited. The fact remains equity markets higher returns than bond markets lower volatility. Listed equity market, established in 1973, provides superior alternative equities hedged options.

Investment markets offer hedging vehicles.

Best is a **put option**. A put option gives the buyer only if the value of the stock declines below a pre-determined price, again at a premium. The cost of the put is the premium.

Second hedging vehicle is **call option**. A call gives the holder the right to purchase stock at a predetermined price, again at a premium. The hedging benefit of the call accrues to the holder who receives the cash premium.

Premiums, which are directly related to stock price volatility, are continuously sold on all options on existing portfolio.

It provides a substantial hedging benefit. The premium establishes the potential return and can act as an offset to falling prices in the portfolio. The call seller's position is limited to the amount of premium received. Selling is an effective hedge in protracted bear markets such as 2000-2001 and 1973-1974.

Writing call options provides an actively measurable but limited

hedging benefit. Put options provide the downside floor. Put options, conceptually similar to

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www.gatewayfund.com

insurance protection, are expensive unless a "deductible" feature is added. Put options have proven to be very effective at reducing the impact of sharp declines such as occurred in October 1987, August 1990, August 1998, and September 2001 but are less effective in a slowly eroding bear market.

Combining the two approaches provides a surprisingly

effective strategy. If puts are structured with a deductible, the call premiums can pay the cost plus, in most cases, allow a respect-

able, objectively measurable expected return. The resulting investment—equity plus options—mimics the volatility of fixed income with consistent returns and low downside exposure. Investors seeking to rejoin the equity market and limit volatility will find the combination appealing in the uncertainty surrounding future financial markets.

Using Discipline in an Undisciplined Environment

U.S. individuals stampeded out of equity mutual funds in September. The \$25 billion in net outflows was the largest on record. Although we have no evidence yet, history suggests that professional investors were not large sellers. Why do institutions and individuals often behave so differently when it comes to investing?

Disciplined Approach:

Professionals begin by assessing their goals, their risk tolerance and their time horizon. These are incorporated into a long-term plan centered on strategic asset allocation. Many individuals often make changes based on emotions rather than long-term goals. Often, even when individuals plan strategically, they deviate from their plan when the market is too

"Often, even when individuals plan strategically, they deviate from their plan when the market is too challenging or too tempting."

challenging or too tempting. As any dieter can attest, the hard part is sticking to it! The professional investor adheres to the plan, including periodically rebalancing to reflect the differing returns of the assets. For example, stocks have underperformed bonds in 2001.

An investor who began the year with a 50-50% allocation will now have a mix that is high in bonds, low in stocks. The professional will sell bonds and buy stocks to bring the ratio back to

50-50%, reducing the high performer and buying the laggard. Individuals, reacting emotionally rather than acting strategically, did the opposite this year, selling out of stocks in September at a "low" and buying into bonds at a "high".

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Seneca provides investment management services to institutional and private clients. Founded in San Francisco in 1989, Seneca manages over \$14B in growth equity and fixed income. The firm is owned by its investment professionals and Phoenix Investment Partners, a strategic partner. Its success is attributable to the stability of its staff, client base and ownership; a disciplined investment approach tested over full market cycles; and an enviable long-term track record.

San Francisco, CA 415-486-6600
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A Silver Lining:

The recent bear market has provided a window of opportunity for taxable investors to adjust portfolios without the same tax impact as in the past. This is a good time to rebalance portfolios, gain proper diversification and harvest losses to take against future gains. Acting like a professional has never been easier.

The Elements of Investment Discipline:

- Don't chase performance—it can be hazardous to your wealth!
- Act strategically, not emotionally.
- Build an investment plan.
- Rebalance your portfolio regularly.
- Stick to your plan even when your emotions tell you to do the opposite.
- Seek professional advice when you do not have the tools, the time or the experience to do it yourself.

"People love performance products with emotional, inspiring design. Consumers everywhere are demanding not only great aesthetics, but a fusion of design and technology in both form and function that reimagined lives. We thank IDSA and *BusinessWeek* for recognizing our passion for creating great, motorcycle and products that not only move our customers physically as top industrial driving machines, but move their hearts as well."

—Chris Bangle, Chief of Design, BMW AG, Germany

GOOD

"OXO International is dedicated to providing innovative consumer products that make everyday living easier."

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Having exposure to the consumer and the business world through *BusinessWeek* magazine is a nice bonus as well.

—Alex Lee, President, OXO International

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PAYS

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—Bill Werner, Corporate Vice President and General Manager, DEN subscriber Products Group, Motorola

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IBM, Microsoft, Apple Computer, Nike, Garmin/Pharos, FedEx, Samsung and Google. These companies, plus 2001 IDEA winners, show that good design does all: it takes off a business, makes profits, creates customer satisfaction and new product innovation. *BusinessWeek* is again proud to sponsor the Industrial Design Excellence Awards (IDEA) annual competition conducted by the Industrial Designers Society of America. The IDEA is accepting entries from Asia, Europe, Latin America, Canada and other foreign countries for products used in North America. *BusinessWeek* will publish a survey on the winners in June 2002 issue. Design of business and medical equipment, consumer products, apparel and digital media, home consumer, transportation, packaging, environmental solutions and furniture are eligible. The deadline for entry is February 11, 2002.

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BAY-FOR HARD TIMES



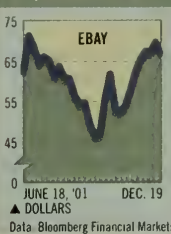
GENE G. MARCIAL

eBay auctioneer can thrive in a sluggish economy. The side group at oncology may be a takeover. Biotech patents would have Acacia going pretty

When, without much fanfare, eBay (EBAY) announced on Dec. 18 that Chief Operating Officer Brian Swette was quitting, shares of the top online auctioneer dropped from 69.29 to 66.81. Nervous investors bailed out, figuring something must be amiss if the head honcho was leaving.

Enter some hotshot pros—who, taking advantage of the tumble, snapped up stock. No, they weren't momentum traders jumping on quick-buck gains. These money managers were scouting for solid stocks that could grow fast despite a slow-growth economy. eBay a moribund-economy play? Exactly, says William Harnisch, president of Forstmann-Leff Associates, which manages \$6 billion. He says eBay is one of the few companies that can sustain speedy growth even in a sluggish environment. Through its Internet properties, eBay has emerged as a global market for antiques, autos, art, coins, collectibles, computers, and toys. It is hard to match online or offline, and "has no real competition," says analyst Derek Brown of W.R. Hambrecht, who rates the stock a strong buy. "eBay is a core Net holding with long-term prospects of 40%-plus operating margins," he adds. True, eBay's price-earnings ratio is a lofty 90, with an \$18 billion market cap. But Harnisch isn't averse to buying a high p-e stock if its growth rate justifies it. He says eBay has been growing at 50% a year. The ratio of eBay's p-e to its growth is 1.8. Harnisch says it deserves to trade at a p-e/growth ratio of 2.5—implying a stock price of 100. He sees eBay earning 48¢ a share in 2001, 75¢ in 2002, and \$1.15 in 2003.

GETTING EVER HIGHER BIDS



US ONCOLOGY: THE PROGNOSIS IS BUYOUT

It isn't often that a stock sends out signals that it's a takeover target. But US Oncology (USON) is one of those rarities. A provider of cancer-care services to 77 cancer centers and 850 doctors in 26 states, US Oncology was formed by the 1999 merger of American Oncology Resources and Physician Reliance Network. Of late, its stock has warmed right up—climbing from 3.95 on Oct. 3 to 7.85 on Dec. 19. An investor group, Welsh, Carson, Anderson & Stowe—led by Russell Carson, a member of US Oncology's board—has upped its stake to 10.3%.

The stock hit 10 in early March but slid to 6 after September 11. It fell

HEATING UP AGAIN



even further, to 4, after the company announced a restructuring on Sept. 30. That's when the Welsh Carson group started scooping up shares. In its filing with the Securities & Exchange Commission, the group said it might "explore a possible acquisition." Obviously Carson, who knows the company well, is betting a lot of money that US Oncology's "restructuring will lead to greater profitability and a higher stock price," notes Charles LaLoggia, editor of the *Super-Stock Investor*, a Rochester (N.Y.) newsletter. Welsh Carson has a record of acquiring big stakes in small medical companies and then taking them private. It looks as if the group will do another deal, says LaLoggia, who figures US Oncology is worth 12 to 13 a share in a buyout.

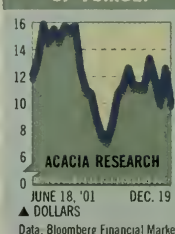
ACACIA IS ALL SET TO BLOSSOM

Acaria Research (ACRI), a small outfit that holds major patents in tech and biotech, has lined up important partnerships, including Switzerland's Roche Group and Japan's Hitachi, in its rush to profitability. For four consecutive quarters, Acacia's loss per share has shrunk, notes Value Line analyst Erik Manning, who thinks the stock, trading at 10 a share, will soon outpace the market.

Acacia's CombiMatrix unit is its crown jewel, says Manning. It makes customized biochips used, among other things, in detecting bio-warfare agents such as bacillus spores—similar to anthrax. Acacia Chairman and CEO Paul Ryan says the biochips are being developed through grants from the Defense Dept. to produce an ultrasensitive handheld system for detecting chemical-warfare agents. CombiMatrix has linked up with Roche, a major maker of diagnostic products, to develop genetic-testing tools for major diseases.

On the tech side, Acacia is talking to AT&T and AOL Time Warner about licensing Acacia's audio-video patents in distributing programs by computer, TV, and satellite. The patent covers video-on-demand services that some companies, such as AOL, already provide, says Ryan. Acacia also holds the patents for the so-called V-chip device, which blanks out specific TV programs for viewers. Acacia has pacts with leading TV makers, including Sony and Mitsubishi, on the V-chips. If Acacia succeeds in forming solid partnerships based on its patent on video-on-demand technology, "it would pull in huge licensing fees," says Ryan.

A YEAR OF TUMULT



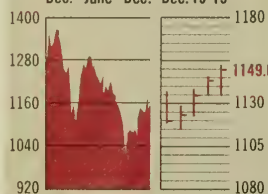
BusinessWeek online

Read Gene Marcial's Inside Wall Street Online column Tuesday afternoons at www.businessweek.com/today.htm. And see him Fridays at 1:10 p.m. EST on CNNfn's *The Money Gang*.

Stocks

S&P 500

Dec. June Dec. Dec. 13-19



COMMENTARY

Stocks rallied in the week ending Dec. 19, paced by the Standard & Poor's 500 index and the Dow Jones' industrial average, which rose 1.1% and 1.8% respectively. IBM led the charge, hitting a 52-week high. But the action was not confined to large-caps: The S&P Small Cap 600 rose 2.3%, followed by the S&P MidCap 400, up 1.3%. The tech-laden Nasdaq, however, slipped 1.4%.

Data: Bloomberg Financial Markets
Bridge Information Systems, Inc.

U.S. MARKETS

	Dec. 19	Week	Year to date	Last 12 months
S&P 500	1149.6	1.1	-12.9	-9.1
Dow Jones Industrials	10,070.5	1.8	-6.6	-2.4
Nasdaq Composite	1982.9	-1.4	-19.7	-15.0
S&P MidCap 400	501.9	1.3	-2.9	4.6
S&P SmallCap 600	228.7	2.3	4.1	14.1
Wilshire 5000	10,682.2	1.1	-12.3	-7.7

SECTORS

	Dec. 19	Week	Year to date	Last 12 months
BusinessWeek 50*	729.1	0.8	-24.8	-25.8
BusinessWeek Info Tech 100**	425.8	-1.8	-24.7	-29.3
S&P/BARRA Growth	602.0	1.7	-12.4	-9.4
S&P/BARRA Value	546.8	0.4	-14.0	-9.5
S&P Energy	793.1	2.2	-14.9	-13.2
S&P Financials	147.2	1.5	-10.6	-5.4
S&P REIT	92.8	-0.2	5.5	6.3
S&P Transportation	685.7	1.5	-1.7	6.2
S&P Utilities	231.5	3.9	-34.0	-30.6
GSTI Internet	105.3	-3.9	-42.0	-47.4
PSE Technology	698.9	-1.5	-14.2	-9.7

*Mar. 19, 1999 = 1000

**Feb. 7, 2000 = 1000

BEST-PERFORMING GROUPS

	Last month %	Last 12 months %
Homebuilding	31.4	70.0
Instrumentation	17.6	53.1
Oil & Gas Drilling	14.9	50.2
Heavy-Duty Trucks	10.1	46.2
Transportation Services	10.0	45.8

EQUITY FUND CATEGORIES

	4-week total return %	52-week total return %
Leaders		
Precious Metals	9.4	25.3
Latin America	9.1	19.3
Technology	6.9	10.8
Small-cap Growth	6.4	10.1
Laggards		
Japan	-7.2	-36.6
Utilities	-4.2	-34.8
Diversified Pacific/Asia	-0.9	-32.6
Foreign	-0.1	-23.7

EQUITY FUNDS

	4-week total return %	52-week total return %
Leaders		
Frontier Equity	23.1	78.2
Van Wagoner Emerging Gr.	17.8	66.4
Van Wagoner Post Venture	16.7	57.4
Van Wagoner Technology	16.5	54.6
Laggards		
ProFunds UltraShort DTC	-15.1	-69.8
Rydex Dynamic Vent. 1DD	-15.1	-69.2
Potomac Internet Short	-11.1	-68.8
Matthews Japan	-11.0	-68.2

GLOBAL MARKETS

	Dec. 19	Week
S&P Euro Plus (U.S. Dollar)	1054.2	-1.2
London (FT-SE 100)	5120.6	0.0
Paris (CAC 40)	4467.9	-0.9
Frankfurt (DAX)	4984.7	-1.5
Tokyo (NIKKEI 225)	10,471.9	-3.1
Hong Kong (Hang Seng)	11,565.2	-2.4
Toronto (TSE 300)	7501.1	-1.0
Mexico City (IPC)	6250.7	1.6

FUNDAMENTALS

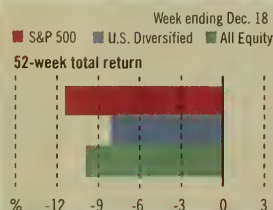
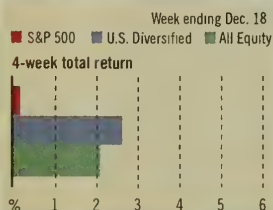
	Dec. 18	Wk. ago
S&P 500 Dividend Yield	1.36%	1.37%
S&P 500 P/E Ratio (Trailing 12 mos.)	46.5	45.8
S&P 500 P/E Ratio (Next 12 mos.)*	21.8	21.7
First Call Earnings Revision*	-3.28%	-2.24%

*First Call Corp.

TECHNICAL INDICATORS

	Dec. 18	Wk. ago
S&P 500 200-day average	1170.5	1173.6
Stocks above 200-day average	51.0%	50.0%
Options: Put/call ratio	0.71	0.71
Insiders: Vickers Sell/buy ratio	2.27	1.29

Mutual Funds



Data: Standard & Poor's

Interest Rates

KEY RATES

	Dec. 19	Week ago
MONEY MARKET FUNDS	1.92%	2.01%
90-DAY TREASURY BILLS	1.68	1.67
2-YEAR TREASURY NOTES	3.07	2.94
10-YEAR TREASURY NOTES	5.04	4.98
30-YEAR TREASURY BONDS	5.44	5.46
30-YEAR FIXED MORTGAGE†	7.15	7.07

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt bonds, assuming a 31% federal tax rate.

	10-yr. bond
GENERAL OBLIGATIONS	4.47%
TAXABLE EQUIVALENT	6.48
INSURED REVENUE BONDS	4.71
TAXABLE EQUIVALENT	6.83

THE WEEK AHEAD

DURABLE GOODS ORDERS Friday, Dec. 28, 8:30 a.m. EST ► New orders for durable goods probably sank 5% in November. That's according to the median forecast of economists surveyed by Standard & Poor's MMS, a division of The McGraw-Hill Companies. In October, durable goods orders soared 12.8%, as orders not placed in September were finally booked. In addition, defense aircraft orders jumped nearly 500%, but the volatile defense category will likely post a large decline for November.

EXISTING HOME SALES Friday, Dec. 28, 10 a.m. EST ► Sales of existing homes are forecast to have slipped 1%, to an annual rate of 5.12 million, in November, from the October pace of 5.17 million. Through October, sales are at an annual rate of 5.25 million homes, better than the 5.12 million for all of 2000.

NEW RESIDENTIAL SALES Friday, Dec. 28, 10 a.m. EST ► New single-family home sales in November probably slipped to an annual rate of 873,000, after an ex-

pected increase, to 880,000 unit in October. Low interest rates have maintained strength in the housing but economists will be watching the recent spike in mortgage rates had an impact on home buying.

CONSUMER CONFIDENCE Friday, Dec. 28, 10 a.m. EST ► The Conference Board consumer confidence index for December likely rose to 83.5, from 82.2 in November. The gain is expected to come rebound in consumers' present out-

BusinessWeek Fifty

THE
BUSINESSWEEK **50**

June

Dec.

Weekly

Daily: Dec. 13-19

760

740

729.1

720

700

680

0.8% for the week. Financials, including credit-card companies Provident Financial, up 14.0%, Citigroup, up 4.4%, led the charge. The big news, however, was Citigroup's plan to sell its Casualty unit to the public, in a deal expected to raise some \$5 billion. Citi rose 3.8%. Tech stock, with Scientific-Atlanta losing 19.9% and Texas Instruments 13.4%.

COMPANY PERFORMANCE

% change

Week Since
3/1/01

Rank

Company

% change

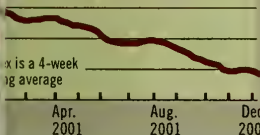
Week Since
3/1/01

ational	2.2	4.8	26	Verizon Communications	2.3	0.0
Petroleum	2.1	-16.6	27	Citigroup	3.8	2.8
	-7.7	-67.0	28	Sun Microsystems	-7.6	-37.9
	-4.5	-48.9	29	Merck	1.4	-25.6
aterials	-7.8	-8.7	30	El Paso	12.3	-38.4
inancial	14.0	-93.4	31	Altera	-10.2	-12.1
Petroleum	3.1	6.8	32	Marsh & McLennan	4.7	2.6
	8.1	-14.7	33	Household International	5.0	-2.6
	3.4	-19.6	34	ChevronTexaco	2.2	0.8
	-1.2	-30.2	35	SBC Communications	3.0	-13.5
others Holdings	-0.5	-2.5	36	Mercury Interactive	1.1	-39.1
	-9.9	-65.8	37	ADL Time Warner	1.6	-24.9
	4.9	-72.4	38	Washington Mutual	-0.1	-6.5
oratories	3.8	18.6	39	General Dynamics	-1.8	17.0
n Financial	4.2	-5.8	40	Comcast	-5.2	-12.4
hnology	-5.2	-16.2	41	Morgan Stanley Dean Witter	1.4	-12.3
	-7.1	-5.4	42	Tellabs	-9.5	-66.3
ess	3.1	-17.4	43	Exxon Mobil	2.5	-5.8
gy	9.2	-8.9	44	Scientific-Atlanta	-19.9	-50.9
ommunications	-8.6	-56.5	45	U.S. Bancorp	2.8	-12.9
e Financial	4.4	-7.3	46	Paychex	-8.7	-9.7
roleum	2.8	8.1	47	Merrill Lynch	-1.1	-13.0
ices	-1.7	9.5	48	Bed Bath & Beyond	2.6	29.7
rces	5.4	-13.9	49	Texas Instruments	-13.4	-13.9
health	-2.0	-4.5	50	Teradyne	-4.6	-4.0

Production Index

Change from last week: -0.5%
Change from last year: -10.4%

AL OUTPUT Dec. 8=158.6 1992=100



index was down during the latest week. tion of the four-week moving average, ed to 157.2, from 158.2. After season- , the decline was evenly distributed, with ponent lower for the week. Lumber, a-e-oil refining, and steel production all e declines. Electric power and rail-freight n narrowly, while truck assemblies post-ase.

ch of the index components is at www.business-week.com.
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54 million Americans have disabilities. Two-thirds of those of working age do not have jobs. It is a mistake to ignore these talented individuals who prove their capacity to overcome challenges each and every day.

Our goal is for people with disabilities to fully participate in all aspects of life—including the workplace. The following members of our CEO Council help us fulfill this mission. They realize that hiring people with disabilities is not just a good thing to do, it's good business.

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HEALING WOUNDS, LEARNING LESSONS

It's nearly over. Americans are greeting the end of 2001 with unalloyed relief. Rarely has a year brought so much pain and turmoil to so many. One calamity followed another, with brutal terrorism compounding a recession that fell over a country still reeling from a divisive Presidential election. But in the long sweep of time, 2001 may well be perceived as the year when Americans withstood the cauldron of crisis, relearned basic verities about their society, and used them to navigate difficult times ahead. For 2001 was clearly a watershed, and the world of 2002 and beyond will be a very different place. As the new year quickly approaches, it is well worth taking a moment to consider the lessons learned from the trauma of recent events.

► **Values Count.** The horror of the World Trade Center and Pentagon attacks revealed that the Old America of shared values, not competing interest groups, of common cause, not hateful opposition, still thrives beneath the showy veneer of partisan politics and me-now materialism. The respect suddenly paid to people in uniform—firefighters, police, and soldiers—and their values of sacrifice and courage was startling in a society that only recently held telegenic financial analysts and techno-billionaires in thrall. The outpouring of patriotism and the generosity of charity was as surprising as it was comforting. And overseas, the sight of women in Kabul daring to show their faces to smile, old people listening to music, and children flying once-forbidden kites was a powerful reminder that civilizations preaching hatred and repression are not equal to those believing in tolerance and opportunity. The challenge ahead is to remember what unites us, not what divides us, to embrace America's secular values of democracy, religious pluralism, opportunity, and individual liberty, and to reject the voices of homegrown hatred, such as Jerry Falwell declaring after September 11 that the country brought death and destruction on itself because of abortion, homosexuality, and the American Civil Liberties Union.

► **Pragmatism Counts.** The adaptability and flexibility of American society in the face of crisis proved crucial in 2001. Policy changed abruptly to deal with extreme situations. A Republican Administration that catered to the notion that government is usually the problem turned on a dime to ensure that government became the solution. After 9/11, billions of federal dollars went to helping New York cope and to keep the airlines solvent and flying. Airport security was taken over by federal authorities. Politicians of both parties rallied around the President to join in the delicate task of curbing civil liberties to fight a war while insisting on sunset clauses to return those rights to the people once the battle is over. On the economic front, as growth plummeted, the Bush Administration and Congress passed an unprecedented income-tax rebate in the summer to get money into the hands of consumers and boost demand, while Federal Reserve Chairman Alan Greenspan moved with incredible speed to

lower rates and add liquidity to the financial system. The lunge ahead is to retain this new pragmatism and not retreat to ideological partisanship in Washington, to accept different political views without the left or the right impugning the integrity of those expressing dissent.

► **Security Counts.** The terrorist attacks on New York and Washington ended America's sense of invulnerability, lowering the fall of communism, the U.S. took security granted and focused its energies on economic affairs, enjoying the tech boom of the late '90s and expanding market capitalism around the globe. Security will now play a much bigger role in American lives. It will sharply boost military spending, reorder budgetary priorities, and put constraints on discretionary spending for other programs. The success of high-combat in Afghanistan will lead to a transformation of the military and may also bring Silicon Valley closer to the Pentagon. Geopolitics will intrude on globalization, much as it did during the cold war. Corporations will raise the importance of political factors when they invest around the world. The terrorist attacks on America's homeland may well transform foreign policy. In a post-9/11 world order, Europe, NATO, Japan, the U.N. probably matter less to U.S. security than Russia, Britain, Turkey, and a host of alliances with Central Asian and Middle Eastern states. But unilateralism has its own pitfalls, and the challenge ahead is for the U.S. to build a security coalition with broad, common, global goals.

► **The Equity Culture Counts.** The sharp downturn in the business cycle is a powerful reminder that Joseph A. Schumpeter's "creative destruction" is working its way quietly through the U.S. economy. Sustained productivity increases suggest a return to profitability and growth sometime in 2002. The system is proving flexible, and the U.S. will emerge from recession quickly and in better shape, in contrast to Japan or even Europe. The stock market is already reflecting an upturn. This is good news since stocks have come to play a dominant role in financing growth, rewarding enterprising and compensating employees, and securing retirement. But the dot-com blowup, the high-tech meltdown, and the Enron Corp. disaster have revealed big holes in the foundation of the nation's equity culture. Opaque off-balance-sheet partnerships that hide debt, corporate regulations that undermine 401(k)s, auditing firms that don't question numbers, and Street analysts who never say "sell" raise the risk of overinvesting. The financial lesson of this business cycle may be that bottom-line numbers have become so unreliable that the nation's well-being of the nation is threatened. The challenge ahead in restoring credibility to the equity culture are in Washington to get tougher, Wall Street to demand honesty, and Corporate America to come clean.

Tragedy and crisis have the power to reveal and teach, and Americans have learned much these past months. The year may well see the rebuilding of New York, the rebirth of the economy, and the rebirth of the nation's spirit.

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